

SALARY INCOME

[Sec. 15 to 17, Sec. 10(10) to 10(14), Rule 3]

Basic Concepts for Taxability of Salary Income:

The following aspects should be understood for the taxability of ‘Salary’:

- **Existence of Employer-Employee Relationship:** For charging an income under the head ‘Income from Salaries’, there must be an employer-employee relationship between the payer and payee. Employer-Employee relationship is different from Contractor-Contractee relationship or Principal-Agent relationship. An employee is one who works under the **direct control and supervision of his employer**.
- **Any payment or benefit received from employer:** Once an employer-employee relationship is established, then any **payment or value of any benefit** received by an employee from his employer is taxable as ‘salary’. For e.g. fees, commission, bonus, perquisites, etc. received from employer. Thus, emoluments or benefits, even if received in kind, are taxable under this head. There is no distinction between gratuitous payment and contractual payment.
- **‘Salaries’ v/s ‘Wages’:** ‘Salaries’ and ‘Wages’ are conceptually not different, both are paid for work done. Wages are normally paid on daily basis for manual work whereas salary is normally paid on monthly basis. Income-tax Act views no difference between salary and wages; therefore both are taxed under the same head and at the same rate.
- **Salary from past/prospective employer:** Any amount even if received from a past employer on account of the employment shall be taxable as salary income e.g. Pension, Termination Bonus, etc. Even any amount received from a future or prospective employer for taking employment shall be taxable as salary, though employer-employee relationship is yet to come in existence.
- **Salary of M.P. / M.L.A. / M.L.C.:** Even though remuneration paid to M.P, M.L.A or Member of Legislative Council (M.L.C) is called ‘salary’, it is not taxable as ‘salary’ as there is no employer-employee relationship between Government and M.P./ M.L.A./M.L.C. In CIT v. Shiv Charan Mathur (2008) (Raj.), it was observed by the High Court that MPs and MLAs are not employed but are elected by the public, and as a result of which they acquire constitutional position. Their remuneration is not salary because of absence of employer-employee relationship and therefore, such remuneration will be taxable as ‘Income from Other Sources’ and not as ‘Salaries’.
- **Salary to a Director of a Company:** A director may or may not be an employee of the company. If as per the agreement, he assumes the position as an employee then his remuneration will be taxable as ‘salary’, but if he is not an employee of the company, then his remuneration will be taxable either as ‘Profits and Gains of Business or Profession’ or as ‘Income from other sources’.
- **Pension:** Monthly or periodical Pension received by the assessee after his retirement is taxable as Salary. Pension received by the Family members/Legal Heirs of the assessee upon death of the assessee is taxable in the hands of recipient as ‘Family Pension’ under the head ‘Income from other sources’ and not as ‘salary’.
- **Advance against salary:** The terms ‘Advance Salary’ and ‘Advance against salary’ are different. ‘Advance salary’ is taxable when received. But ‘Advance against salary’ is not an income. It is like a loan taken against security of salary and hence not taxable.

- **Arrears of Salary:** Arrears of salary means earlier year's salary which was never due to employee earlier, but has now become due and is now being received by him. Arrears of salary may arise due to 'revision in pay-scale with retrospective effect' or due to 'court's order to increase the pay with retrospective effect'. It is taxable only **on receipt basis** in the year of receipt and not on due basis.
- **Grade of Salary:** When salary is offered in a particular Grade/Scale. For e.g.: in the Grade of ` 24,000-2,000-48,000: this means that initially the monthly salary is ` 24,000 p.m. and it will be increased by ` 2,000 p.m. at the end of every year, till monthly salary reaches ` 48,000 p.m. and thereafter there will be no increment in the salary. First year salary will be ` 24,000 p.m. and second year salary will be ` 26,000 p.m. Thereafter, it will be increased to ` 28,000 p.m. in the third year of his service and so on, till monthly salary reach the level of ` 48,000.
- **Foregoing of salary:** Salary foregone by an employee is basically an accrued salary which is waived subsequently, and so it is chargeable to tax.
- **Surrender of Salary under 'Voluntary Surrender of Salaries (Exemption from Taxation) Act, 1961':** When an employee surrenders his salary to the credit of the Central Government u/s 2 of 'Voluntary Surrender of Salaries (Exemption from Taxation) Act, 1961', the amount so surrendered is excluded from the salary and is **fully exempt**.
- **Salary from United Nations Organization:** Salary received from United Nations Organization (U.N.O) or any other allowances, perquisites or pension received from U.N.O. is **not taxable**.

Basis of Charge [Sec. 15]

Charge of Salary is on Due or Receipt basis, whichever is earlier. Method of accounting followed by the employee-assessee is **irrelevant**.

- Any salary **due** from an employer or a former employer to an assessee in the previous year, whether paid or not, is chargeable to tax on due basis.
- Any **advance salary** received from the employer before it becomes due, shall be taxable in such year of receipt.
- Any **arrears of salary** paid or allowed by the employer or former employer, if not taxed in any earlier previous year, shall now be taxable in the year of receipt.

Explanation 1: Where any salary paid in advance is included in the total income of any person for any previous year it shall **not be included again** in the total income of that person when the salary becomes due.

Explanation 2: Any salary, bonus, commission or remuneration, by whatever name called, due to, or received by, a partner of a firm from the firm shall not be regarded as 'salary' for the purposes of this section.

Place of Accrual of Salary: [Sec. 9(1)]

Salary is deemed to accrue or arise at the place where the services are rendered.

Exception: Salary received by an Indian Citizen from Government of India for services rendered outside India is deemed to have accrued or arisen in India, even though such services are rendered outside India. But, in such case, value of all perquisites and allowances received by such person from Government of India outside India are exempt from tax under section 10(7).

Definition of Salary under Income-tax Act: [Sec. 17(1)]

The term 'Salary' has been defined u/s 17(1) which includes the following;

- (a) wages;
- (b) any annuity or pension;
- (c) any gratuity;
- (d) any fees, commissions, perquisites or profits in lieu of or in addition to any salary or wages;
- (e) any advance of salary;
- (f) any payment received by an employee in respect of any period of leave not availed by him;
- (g) the annual accretion to the balance at the credit of an employee participating in a recognised provident fund, to the extent to which it is chargeable to tax;
- (h) the aggregate of all sums that are comprised in the transferred balance of an employee participating in a recognised provident fund to the extent to which it is chargeable to tax;
- (i) the contribution made by the Central Government or any other employer in the previous year, to the account of an employee under a notified pension scheme referred to in section 80CCD.

Allowances
House Rent Allowance [Sec. 10(13A) read with rule 2A]

Least of the following is **exempt** from tax in respect of House Rent Allowance [H.R.A.]:

- a. 50% of salary, if the house taken on rent is situated in Mumbai, Delhi, Chennai, Kolkata; (40% of salary, in any other case); or
- b. Actual H.R.A.; or
- c. Rent paid as reduced by 10% of Salary.

POINTS TO NOTE:

- Here, the term 'Salary' means the Salary defined in the case of **Gestetner Duplicators (P) Ltd. (SC)** which includes only the following:
Basic salary
 + Dearness allowance (only if it forms part of salary for computation of retirement benefits)
 + Commission based as a fixed percentage of turnover achieved by the employee.
- Here, the salary shall be determined on 'Due' basis for the period during which rental accommodation is occupied by the employee.
- The exemption shall be calculated **month-wise** and then aggregate for the whole year.
- Exemption under this section shall not be available, where an employee lives in his own house or in a house for which he does not pay rent.

Entertainment Allowance [Sec. 16(ii)]

Entertainment allowance shall be first included in 'Gross Salary' and then deduction shall be given.

The deduction of Entertainment allowance is available only to **Government employees** (here employees of Central govt. or of State govt.) as **least of the following**:

- a. ` 5,000 for the year, or
- b. 1/5th of **Basic Salary**, or
- c. **Actual** entertainment allowance.

Allowances Exempt to the extent of Expenditure incurred: [Sec. 10(14)(i)]

The following allowances shall be exempt to the extent of amount actually spent from such allowances as they are meant for the official purposes/duties:

1. Travelling allowance/Transfer allowance (to meet the cost of travel on office tour or on transfer)
2. Conveyance allowance (to meet the expenditure on conveyance in performance of office duties, but not for conveyance between office and residence)
3. Daily allowance (to meet the ordinary daily expenses incurred by an employee on office tour/travel)
4. Helper allowance (to meet the expenditure on helper engaged in performance of office duties)
5. Research allowance (for encouraging academic research and other professional pursuits)
6. Uniform allowance (to meet the expenditure on purchase and maintenance of uniform for wear during performance of office duties)

Allowances Exempt to the extent of Amount Specified: [Sec. 10(14)(ii)]

Amount to the extent specified below are exempt from tax:

- **Children Education allowance:** Upto ` 100 p.m. per child (maximum for 2 children)
- **Hostel Expenditure allowance:** Upto ` 300 p.m. per child (maximum for 2 children)
- **Tribal area, Scheduled Area/Agency area allowance:** Upto ` 200 p.m.
- **Special compensatory hilly area allowance or high altitude allowance etc.:** Varies from ` 300 to ` 7,000 p.m.
- **Border area, remote area distributed area allowance:** Varies from ` 200 p.m. to ` 1,300 p.m.
- **Compensatory field area allowance:** Upto ` 2,600 p.m.
- **Compensatory, modified field area allowance:** Upto ` 1,000 p.m.
- **Counter insurgency allowance granted to members of armed forces:** Upto ` 3,900 p.m.
- **Transport allowance:** Upto ` 3,200 only if the employee is blind, deaf, dumb or orthopedically handicapped.
- **Allowance for employees of Transport system:** Lower of ` 10,000 p.m. OR 70% of such allowance.
- **Underground allowance for working in uncongenial, unnatural climate in underground mines:** Upto ` 800 p.m.
- **High Altitude (uncongenial climate) allowance to members of armed forces:** For altitude of 9,000 ft to 15,000 ft ` 1,060 p.m. and for altitude above 15,000 ft ` 1,600 p.m.
- **Special compensatory highly active field area allowance to members of armed forces:** Upto ` 4,200 p.m.
- **Island (duty) allowance to the members of armed forces in the Andaman & Nicobar and Lakshadweep group of Islands:** Upto ` 3,250 p.m.

Allowances which are exempt for certain categories of persons:

- (i) Allowances to a citizen of India, who is a Government employee, rendering services outside India. [Sec. 10(7)]

- (ii) Allowances to High Court judges u/s 22A(2) of the High Court Judges (Conditions of Service) Act, 1954.
- (iii) Sumptuary allowance given to High Court and the Supreme Court judges.
- (iv) Allowance received by an employee of UNO from his employer.
- (v) Notified allowances paid to both serving and retired chairman and members of UPSC.

Certain Allowances Fully Taxable:

Allowances, other than exempted above, are fully taxable, by whatever name called.

List of few such allowances which are fully taxable are as under:

- City compensatory allowance,
- Dearness allowance,
- Lunch/Tiffin allowance,
- Fixed Medical allowance,
- Servant allowance,
- Overtime allowance,
- Warden allowance, etc.

NOTE: Allowance paid to a Judge of a High Court is not taxable.

Taxability of Perquisites

Definition of Perquisite under Income-tax Act [Sec. 17(2)]:

The term '**perquisite**' is defined in an inclusive manner which includes the following:

- (i) The value of rent-free accommodation provided to the assessee by his employer;
- (ii) The value of any concession in rent of any accommodation provided to assessee by the employer;
- (iii) The value of any benefit or amenity granted or provided free of cost or at 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 being a person who has a substantial interest in the company;
 - (c) by any employer (including a company) to an employee whose salary (exclusive of all benefits or amenities not provided for by way of monetary payments) exceeds ` 50,000.
- (iv) Any sum paid by the employer in respect of any obligation which, but for such payment, would have been payable by the assessee;
- (v) Any sum payable by the employer, whether directly or through a fund, other than a recognised provident fund or an approved superannuation fund or a deposit-linked insurance fund, to effect an assurance on the life of the assessee or to effect a contract for an annuity;
- (vi) The value of any specified security or sweat equity shares allotted or transferred directly or indirectly by the employer or former employer free of cost or at concessional rate to the assessee;
- (vii) **The amount or aggregate of amounts of any contribution made to the account of the assessee by the employer:**
 - (a) in a recognised provident fund;
 - (b) in the scheme referred to Sec. 80CCD(1); and
 - (c) in an approved superannuation fund,

to the extent it exceeds ` 7,50,000 in a previous year;

[Amended by Finance Act, 2020 w.e.f. A.Y. 2021-22]

(vii) The annual accretion by way of interest, dividend or any other amount of similar nature during the previous year to the balance at the credit of the fund or scheme referred to in sub-clause (vii) to the extent it relates to the contribution referred to in the said sub-clause which is included in total income under the said sub-clause in any previous year computed in such manner as may be prescribed. *[Inserted by Finance Act, 2020 w.e.f. A.Y. 2021-22]*

(viii) The value of any other fringe benefit or amenity, as may be prescribed.

Reason for Amendment:

Under the current provisions, there is no combined upper limit for the purpose of deduction on the amount of contribution made by the employer. This is giving undue benefit to employees earning high salary income since, an employee with low salary income is not able to let employer contribute a large part of his salary to all these three funds and employees with high salary income are able to design their salary package in a manner where a large part of their salary is paid by the employer in these three funds. Thus, this portion of salary does not suffer taxation at any point of time, since Exempt-Exempt-Exempt (EEE) regime is followed for these three funds. Therefore, the Finance Act, 2020 has provided a combined upper limit of ` 7,50,000 in respect of employer's contribution in a year to NPS, superannuation fund and recognised provident fund and any excess contribution is proposed to be taxable.

Consequently, it is also proposed that any annual accretion by way of interest, dividend or any other amount of similar nature during the previous year to the balance at the credit of the fund or scheme may be treated as perquisite to the extent it relates to the employer's contribution which is included in total income.

Valuation of Perquisites:

Perquisites provided by the employer (**directly or indirectly**) to the employee or any member of his household, by reason of his employment, shall be chargeable to tax under the head 'Salaries' in the hands of employee. 'Member of household' includes:

- i. Spouse (whether dependent or not);
- ii. Children and their spouses (whether dependent or not);
- iii. Parents (whether dependent or not); and
- iv. Servants and dependents.

Rule 3 of the Income Tax Rules, 1962 contains provisions regarding valuation of perquisites.

Perquisites and taxability for Specified Employees:

The perquisites which are given in Rule 3(3), Rule 3(4), Rule 3(5), Rule 3(6), Section 10(5) and Proviso to Sec. 17(2) [all explained hereunder] shall be taxable only to a specified employee. But, where these perquisites were the obligations of the employee which were met or paid by the employer, then these perquisites are taxable in the hands of all employees, whether specified or not.

The remaining perquisites shall be taxable in the hands of all the employees.

However, the above classification is having a limited application in practical sense because an employee referred to as non-specified employee is one whose annual salary is ` 50,000 or less. Since the exemption

slab for the individuals for the A.Y. 2023-24 is ` 2,50,000, one can infer that majority of the employees who are paying income tax are Specified employees. Therefore, the statement that the perquisites given in Rule 3(3), Rule 3(4), Rule 3(5), Rule 3(6), Section 10(5), Proviso to Sec. 17(2) shall be taxable only to a specified employee does not have much practical utility.

‘Specified Employee’ means

- (i) An employee who is a **director** of the company where he is working at any time during the previous year; or
- (ii) An employee who has **substantial interest** in the company where he is working at any time during the previous year; or
- (iii) An employee whose income under the head **‘Salaries’** exceeds ` 50,000; excluding the value of all benefits or amenities not provided by way of monetary payment.

‘Substantial interest’ means a person who is beneficial owner of the equity shares carrying **20% or more** voting power in the company.

Perquisites Taxable only to Specified employee

Facility of Sweeper, Gardener, Watchman, Cook, etc.: [Rule 3(3)]

The value of such perquisite shall be the actual cost incurred by the employer for providing such services as reduced by the amount, if any, recovered from the employee.

NOTE: Where any house, owned by the employer, is provided to the employee along with a gardener, then the expenses incurred by the employer on maintenance of garden or ground attached to the house (including salary to gardener) shall not be a perquisite for the employee; the reason being that the employer would have, in any case, maintained the garden irrespective of the fact whether the house was provided to employee or kept vacant.

Supply of gas, electricity or water: [Rule 3(4)]

- If such facilities are provided out of resources owned by the employer, then the value of perquisite for the employee shall be the amount of manufacturing cost of such facilities to the employer.
- However, if the same are purchased by the employer from outside agency, then the value of perquisite for the employee shall be the purchase cost to the employer.

In both the cases, the value of perquisite shall be reduced by any amount, if any, recovered from employee.

Education Facilities: [Rule 3(5)]

Training of Employees: Expenditure incurred on training provided to the employee is **not taxable**.

Reimbursement of School fees: Reimbursement of expenditure incurred for the education of the family members of the employee is **taxable** as perquisite in all cases.

Education Facility in Employer’s Institute:

If education facility is provided to the children or member of household of the employee-

- in an institution owned by the employer; or
- in any other institution by reason of employee’s employment,

then, the cost of such education in a similar institution, in or near the locality, as reduced by any amount paid or recovered from the employee shall be taken to be the value of the perquisite.

If it is provided to the children of the employee and the cost of such education or the value of benefit does not exceed ` 1,000 per month per child, the perquisite value shall be taken as Nil. But, where the value of such perquisite exceeds ` 1,000 p.m. per child, then the whole of such perquisite shall be taxable in the hands of the employee and **no standard deduction of ` 1,000 per month per child shall be allowed.**

This exemption of ` 1,000 p.m. shall not be available if such education facility is provided to any other family members of employee (not being children of employee).

Child includes adopted child or step child, but not grandchild.

CIT (TDS) v. Director, Delhi Public School (2011) 202 Taxman 318 (Punj. & Har.)

The limit of ` 1,000 p.m. per child shall not be allowed as standard deduction, while computing the perquisite value of free or concessional education facility provided to the employee by the employer. If the value of perquisite for free/concessional educational facility arising to an employee exceeds ` 1,000 p.m. per child, the whole perquisite shall be taxable in the hands of the employee. It is only in case the perquisite value is less than ` 1,000 p.m. per child, the perquisite value shall be Nil.

Leave Travel Concession: [Sec. 10(5)]

Leave travel assistance provided by the employer to the employee for going anywhere in India along with his family is exempt under following circumstances:

Circumstances	Amount of exemption
• Where journey is performed by air	Amount of economy class air fare of the National Carrier by the shortest route or the amount spent, whichever is less.
• Where journey is performed by rail or • Where the place of origin of journey and destination are connected by rail and journey is performed by any other mode of transport other than air.	Amount of AC first class rail fare or the amount spent, whichever is less.
• Where the place of origin of journey and destination are not connected by rail: ➤ Where a recognized public transport exists. ➤ Where no recognized public transport exists.	Amount of First class or deluxe class fare or the amount spent, whichever is less. Amount of AC first class rail fare or the amount spent, whichever is less

POINTS TO NOTE:

- **‘Family’** includes spouse, children, parents, brothers and sisters of the employee, who are wholly or mainly dependent on employee.
However, family does not include more than two surviving children born on or after Oct 1, 1998. For the purpose of limit of two children, children born out of multiple births after the first child will be treated as ‘only one child’.
- The exemption is available only for the **shortest route**.

- The exemption will be available **only for 2 journeys** performed in **one block of 4 years** commencing from 1986. **Recent specified blocks are: Calendar Years 2014-17 and 2018-21.**
- In case, if the assessee has not availed the two leave travel concession during the specified block of four years, then exemption can be claimed in the first calendar year of the next block (but only in respect of one journey).
- Exemption is limited to actual expenditure incurred and no exemption will be available without performing journey.
- No Exemption allowed if the family members are travelling separately without the employee.
- Leave Travel Concession given to an employee, being a **foreign citizen is taxable.** [Sec. 10(6)(i)]

Medical Facilities: [Proviso to Sec. 17(2)]

Taxability of perquisite in respect of Medical facility provided by the employer **to the employee and his 'family' members** is given hereunder:

Note: Here, 'Family' includes-

- spouse and children of the individual,
- parents, brothers and sisters of the individual, **wholly or mainly** dependent on the individual.

Medical facilities in India:

- Medical facilities provided by the employer in the following hospitals/clinic is **not taxable at all:**
 - Hospital owned or maintained by the employer;
 - Hospital of Central Government/ State Government/Local authority;
 - Private hospital recommended by government for treatment of government employees.
- Any sum incurred or reimbursed by the employer for expenditure incurred by the employee on treatment of **specified diseases prescribed in Rule 3A, in any hospital approved by the Chief Commissioner**, shall **not be taxable at all.**

Medical facilities outside India:

Cost of medical treatment and cost of staying abroad of employee or his family member along with one attendant.	Exempt upto the limit permitted by the RBI.
Cost on travel of employee or his family member along with one attendant.	Full Exempt if the GTI of the employee does not exceed ` 2,00,000.

Use of Motor Car facility [Rule 3(2)]

Circumstances	Used by Employee for	Taxable Value
(i) Where the car is owned (or taken on hire) and also maintained by employer.	Personal purposes	10% of the original cost of Car (or the hire charges, if taken on hire) + maintenance charges (including driver cost, if any)
	Both Official and personal purposes	FLAT ` 1,800 p.m.* or ` 2,400 p.m.** (plus ` 900 p.m. for driver, if any)
(ii) Where the car is owned by employer (or taken on hire),	Personal purposes	10% of the original cost of Car (or the hire charges, if taken on hire)

but maintained by employee.	Both Official and personal purposes	FLAT ` 600 p.m.* or ` 900 p.m.** (plus ` 900 for driver, if any)
(iii) Where the car is owned by employee, but maintained by employer.	Personal purposes	Cost incurred by employer (including driver cost, if any)
	Both Official and personal purposes	Cost incurred by employer (including driver cost, if any) Less: ` 1800 p.m.* or ` 2400 p.m.** Less: ` 900 for driver, if provided.
The above taxable value shall be <i>reduced by any amount recovered from the employee</i> (except in Point i and ii, where FLAT amount is taxable).		

* For car upto 1,600CC (1.6 litres cubic capacity)

** For car above 1,600CC (1.6 litres cubic capacity)

NOTE:

- The word 'Month' denotes **every completed month** and a **part of the month is to be ignored**.
 - Car facility provided only for conveyance between office and residence is not taxable.
 - Where it is claimed that the car is used **wholly for official purposes** and so nothing should be taxable, the **following conditions are to be satisfied**:
 - The employer has to maintain **complete details of journey** taken for official purpose including date of journey, destination, mileage, and the amount of expenditure incurred thereon; and
 - The employer gives a **certificate** that the expenditure was incurred wholly and exclusively for the performance of official duties.
- The above conditions are also to be satisfied if a car is owned by the employee, but the expenses are incurred or reimbursed by the employer and the employee claims that the expenses for official purposes is more than ` 1,800 p.m. (or ` 2,400 p.m. if cc rating of car exceeds 1,600 cc).
- If an employer provides two or more cars, then the taxable value of one car shall be determined as use for partly official and partly personal purposes and for remaining cars it shall be determined as used for personal purposes.

Free transport provided by a Transport Undertaking to its employees: [Rule 3(6)]

The value of such perquisite shall be value at which the **employer offers such benefit to the public** as reduced by the amount, if any, recovered from employee.

However, such perquisite shall not be taxable to employees of railways and airlines.

**Following Perquisites taxable to All Employees,
whether specified or non-specified.**

Rent free Unfurnished Accommodation. [Rule 3(1)]

- (i) **For government employees (CG or SG):** The value of perquisite will be equal to the **license fee** determined by the Central or State Government for allotment of houses to its officers.
- (ii) **For private sector or other employees:** The value of perquisite shall be:

Population of the city as per 2001	Value of perquisite
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census where accommodation is provided	If accommodation is owned by the employer	If accommodation is taken on lease or rent by the employer
10 lakhs or less	7.5% of salary	15% of salary OR Rent paid by employer whichever is less, irrespective of population.
More than 10 lakhs but upto 25 lakhs	10% of salary	
More than 25 lakhs	15% of salary	

POINTS TO NOTE:

- Here, **Salary** means basic salary, dearness allowance (only if its forms part of salary for computing retirement benefits), commission, fees, all other taxable allowances and any monetary payment not in the nature of perquisites (e.g. overtime premium).
- Salary shall be calculated on **accrual basis** and only **for the period during which the accommodation is provided**.
- Where the assessee is employed with more than one employer during the same period, the salary from **all the employers** will be taken into consideration.
- On transfer, if the employee shifts from one place to another and he is provided accommodation at new place of posting while retaining the accommodation at old place, then the value of perquisite shall be determined only for one such accommodation which has **lower value for upto 90 days**. If employee retained both the accommodation for more than 90 days, then he will be chargeable for both the accommodation provided.
- '**Accommodation**' includes house, flat, farm house, hotel, motel, service apartment, guest-house, caravan, mobile home, ship or other floating structure.

Rent-free Furnished Accommodation. [Rule 3(1)]

First find out the value of perquisite in respect of unfurnished accommodation as above and then,

Add: 10% of the original cost of Furniture
or as the case may be.
Actual hire charges of Furniture to the employer

Less: Any amount, if any, recovered from the employee.

NOTE: 'Furniture' includes radio sets, television sets, refrigerators, air-conditioners and other household appliances.

CIT v. Shankar Krishnan (2012) 349 ITR 685 (Bom.)

Where the employer had given an interest-free refundable security deposit to the landlord for renting out the premises to the assessee-employee, the notional interest on such security deposit shall not to be included in the perquisite value of rent-free accommodation given to the employee.

Accommodation in Hotel:

The value of perquisite shall be lower of the following:

24% of Salary
or
Actual charges paid or payable by employer.

} as reduced by any amount, if any, recovered from employee.

Salary Income

Here, the term ‘Salary’ means the same as for the perquisite for Accommodation facility.

If accommodation is provided in hotel **for not more than a period of 15 days**, then **nothing will be chargeable** to tax.

Life Insurance Premium [Sec. 17(2)(v)]

Any premium on the life insurance policy or on the annuity of the employee paid by the employer is **taxable** as perquisite in the hands of all employees.

NOTE: If the employer pays insurance premium under the schemes such as Group Insurance Schemes, Employees’ State Insurance Schemes, Fidelity Guarantee Scheme, then it shall **not be regarded as perquisite** for the employees because such schemes are for the benefit of employer.

Interest-free or Concessional Loans [Rule 3(7)(i)]

Value of perquisite shall be calculated as under:

- Take ‘Maximum outstanding monthly balance’ as on the **last day of each month**
x Rate of interest charged by **SBI as on the first day of P.Y.** in respect of
loan for the same purpose
= Interest for one month

Similarly, calculate interest for each month of the previous year by the above method.

Interest for the entire previous year

Less: Amount recovered from employee, if any (.....)

Value of perquisite

The Perquisite will **not be taxable** in the following two cases:

- (i) When the loan is taken for medical treatment of diseases specified in Rule 3A. This exemption is, however, not available to so much of the loan as has been reimbursed to the employee under any medical insurance scheme.
- (ii) Where the amount of original loan (in aggregate) does not exceed ` 20,000.

Value of Travelling, Touring, Accommodation and other expenses for Holiday availed by the employee [other than LTC u/s 10(5)]: [Rule 3(7)(ii)]

Circumstances	Taxable Value of perquisite
(i) Where such facility is maintained by employer, and is not available uniformly to all employees.	The value at which such facilities are offered by other agencies to the public.
(ii) Where such facility is available uniformly to all employees.	A sum equal to the amount of expenditure incurred by the employer
Less: Amount, if any, recovered from employee	

Notes:

- Where the employee is on official tour and the expenses are incurred in respect of **any member of his household accompanying** him, the amount of expenditure so incurred by the employer in respect of such member of household shall **also be taxable**.
- Where any official tour is extended as vacation, the value calculated above shall be limited to the expenses incurred in relation to such extended period of stay or vacation.

Free Food & Non-Alcoholic beverages [Rule 3(7)(iii)]	
Circumstances	Taxable Value of perquisite
(i) Tea, snacks and non-alcoholic beverages provided during business hours.	Nil
(ii) Free meals provided in remote area or offshore installation.	
(iii) Free meals provided during business hours at office/business premises or through paid vouchers.	Exempt upto ` 50 per meal. Circular No. 15/2001
(iv) In any other case	Amount incurred by employer Less: Amount recovered from employee

- Value of any Gift, vouchers or token: [Rule 3(7)(iv)]**
- Gift in kind upto ` 5,000 in aggregate per annum is exempt, beyond which it is taxable. [Circular No. 15/2001]
 - Gift in cash or convertible into money (like gift cheques) is fully taxable.

- Expenses on Credit Cards: [Rule 3(7)(v)]**
- Value of perquisite shall be the amount of expenditure incurred by employer in respect of credit card-
- As reduced by:**
- Expenditure incurred for official purposes (complete details of expenditure is to be maintained by employer and the expenditure is to be certified by the employer); and
 - Amount recovered from the employee.

- Club Expenditure: [Rule 3(7)(vi)]**
- Value of perquisite shall be the expenditure incurred by employer in respect of club facilities -
- As reduced by:**
- Expenditure incurred for official purposes (complete details of expenditure is to be maintained by employer and the expenditure is to be certified by the employer); and
 - Amount recovered from the employee.

- However, following expenditures incurred by employer are EXEMPT in the hands of employee:
- Health club, sports facilities, etc. provided **uniformly to all the classes of employees** by the employer in the employer's premises; or
 - Initial one time deposit or fees for **corporate or institutional membership**, where benefit does not remain with a particular employee after cessation of employment.

- Use of Movable Assets: [Rule 3(7)(vii)]**
- The value of perquisite for use of **laptops and computers** is **NIL** and hence **exempt**.
 - For any other movable asset, taxable value will be:

10% p.a. of the actual cost of asset or The amount of rent or charge paid or payable by employer.	}	as the case may be, as reduced by any amount, if any, recovered from the employee.
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Transfer of any Movable Asset: [Rule 3(7)(viii)]

If the employer transfers any movable asset, directly or indirectly, to the employee or any member of his household, the amount of perquisite shall be calculated as under:

Actual cost of the Asset to the employer
Less: Allowance for normal wear and tear	(.....)
Less: Amount recovered from employee for the transfer	(.....)
Value of perquisite	<u>.....</u>

Allowance for Normal wear and tear:

Movable Assets	% of Normal Wear and Tear
Electronic gadgets	50% p.a. Reducing Balance Method (WDV)
Motor car	20% p.a. Reducing Balance Method (WDV)
Any other asset	10% p.a. Straight Line Method (SLM)

NOTE:

- Normal wear and tear shall be deductible **only for the completed years of use by the employer.**
- Normal wear and tear shall be calculated only if after purchasing the asset and before its transfer, the employer has **used it for his business purpose.**
- ‘**Electronic gadgets**’ means data storage and handling devices like computer, digital diaries and printers. They do not include household appliances like washing machines, microwave ovens, mixers, hot plates etc. these shall be covered under ‘any other asset’. Besides, it is clarified that transfer of assets which are 10 years old shall not attract taxability.

Taxability of Employee Stock Option Plan (ESOPs)

Employee Stock Option means any Specified Securities or Sweat Equity Shares, allotted or transferred **by the present or former employer**, to the employee, directly or indirectly, either **free of cost or at a concessional price.**

Specified Security means a security defined as per Securities Contracts (Regulation) Act, 1956 and where Employees’ Stock Option has been granted under any plan or scheme therefor, includes the Securities offered under such Plan/Scheme.

Sweat Equity Shares means Equity shares issued by a company to its employees or directors at a discount or for consideration other than cash for providing know-how or making available intellectual property rights or value additions, by whatever named called.

Option means a right but not an obligation granted to an employee to apply for the Specified Security or Sweat Equity Shares, at a pre-determined rate.

Taxability of ESOPs as Perquisites under the head ‘Salaries’: [Sec. 17(2)]

ESOP’s are taxable as perquisites in the hands of the employees in the previous year in which shares/securities are allotted / transferred to the employee under ESOPs. The perquisites are not taxable in the year when the employee exercises his option but is taxable only when the shares/securities are allotted under the ESOPs.

Value of Perquisites shall be determined as under:

FMV of the shares on the date on which option is exercised by the employee	xx
Less: Amount paid by or recovered from the employee in respect of the share	<u>xx</u>
Value of perquisites when shares are allotted	<u>xx</u>

Thus, the value of perquisites shall be calculated on the basis of FMV of ESOPs on the date when **employee exercises his option to ESOPs** and not on the date when shares are allotted.

Determination of FMV on the date of Exercise of option: [Rule 40C]

- In case of shares listed in India, the FMV of the share shall be the average of the opening price and closing price on the stock exchange on the date of exercise of an option.
- In case, the share is listed on more than one recognized stock exchanges, the FMV shall be the average of opening price and closing price of the share on the recognised stock exchange which records the highest volume of trading in the share.
- If there is no trading of the share on any recognized stock exchange in India on the date of exercising the option, the FMV shall be the closing price of the share on any recognised stock exchange on a date closest to the date of exercise of the option and immediately preceding such date.
- In the case of unquoted shares, the FMV shall be determined by a merchant banker registered with SEBI.

On transfer of the shares or securities received by the employees under the ESOP, Capital Gain shall be chargeable in the hands of the employee as under:

Period of Holding: As per *Explanation 1 to section 2(42A)*, for any specified security or sweat equity shares allotted or transferred, directly or indirectly, by the employer free of cost or at concessional rate to his employees (including former employees or employees), **the period shall be reckoned from the date of allotment or transfer** of such specified security or sweat equity shares.

Cost of Acquisition: As per section 49(2AA) where the capital gain arises from the transfer of specified security or sweat equity shares referred to in section 17(2)(vi), the cost of acquisition of such security or shares shall be the **FMV** which has been taken into account for the purposes of the said section.

Valuation of any other Perquisite:

The value of any other perquisite or amenity, service, right or privilege provided by the employer shall be determined on the **basis of cost incurred by the employer under an arm's length transaction as reduced by the amount recovered from the employee, if any.**

Perquisites which are Not Taxable. (Tax free perquisites)

- (1) Use of **Telephone or Mobile phone** provided by employer including telephone or mobile bill paid/ payable by employer.
- (2) Use of employer's **Computer or Laptop** for official as well as personal purposes by employee, whether Computer or Laptop is owned by the employer or not.
- (3) '**Conveyance Facility**' provided to employee for covering journey between his/her residence and place of work.

- (4) **One time Corporate Membership Fees or Institutional Membership Fees** paid by employer, wherein an employee can enjoy membership benefits only till the time he is an employee of that employer.
- (5) Free use of a **Health Club or a Sports Club** or any similar facility maintained by employer.
- (6) Goods manufactured by employer and sold to employee at concessional price,
- (7) **Employees' Group Mediciam Premium** paid by employer,
- (8) **Employees' Personal Accident Insurance Premium** paid by employer,
- (9) **Periodicals/Magazines/Journals/News etc.** provided by employer free of cost in the office to the employee,
- (10) **Recreational facility** provided to a group of employees by the employer.

Profits in lieu of Salary [Sec. 17(3)]

The following sums are treated as 'Profits in lieu of salary' and shall be taxable under the head 'Salaries':

- **Compensation** due to or received from the employer or former employer at or in connection with
 - Termination of employment, or
 - Modification of the terms and conditions of employment.
- **Any payment** due to or received from the employer or former employer *except the following*:
 - gratuity exempted u/s 10(10);
 - house rent allowance exempted u/s 10(13A);
 - commuted pension exempted u/s 10(10A);
 - retrenchment compensation exempted u/s 10(10B);
 - payment from an Approved Superannuation Fund u/s 10(13);
 - payment from Statutory Provident Fund (SPF) or Public Provident Fund (PPF);
 - payment from Recognized Provident Fund (RPF) to the extent it is exempt u/s 10(12).
- Any payment from **Unrecognized Provident Fund**, to the extent of employer's contribution and interest thereon.
- Any sum received by the employee under **Keyman Insurance Policy** including sum allocated by way of bonus on such policy.
- Any amount received (in lump sum or otherwise) **prior to his employment** or after **cessation of his employment**.

Keyman Insurance Policy:

Meaning: As per Explanation to section 10(10D), **Keyman Insurance policy** is a Life Insurance Policy taken by a person on the life of another person, who is or was his **Employee**, or is or was **connected in any manner** with his business. Generally, it is taken on the life of key personnel of the assessee-employer.

Taxability: Sums received under a Keyman Insurance Policy, including the sum allotted by way of bonus on such policy, is considered as **Income** u/s 2(24)(xi).

Taxable Head of Income:

- (a) Where the sum is received by an employee under the Keyman Insurance Policy, it shall be deemed to be Profits in lieu of Salary and taxable to him under the head '**Salaries**' [Sec. 17(3)];
- (b) But, where the sum is received by the assessee-employer carrying on any business or profession, it is taxable to him under the head '**Profits and Gains of Business or Profession**' [Sec. 28 (vi)];
- (c) Where the sum is received by a third party or by the employer-assessee not carrying on any business or profession, it shall be taxable under the head '**Income from Other Sources**' [Sec. 56 (2)(iv)].

Treatment of Retirement Benefits

Gratuity [Sec. 10(10)]:

Gratuity is the gratuitous payment made in the nature of loyalty bonus by the employer to the employee at the time of his retirement, but in some cases it may also be paid during the service period.

- **If gratuity is received during the service period**, whether by a government employee or non-government employee, then it is fully taxable and no exemption will be available u/s 10(10).
- **But if gratuity is received after or at time of retirement** then exemption u/s 10(10) will be as follows:
 - **For Government employees:** Fully exempt
 - **For Non-government employees:** There are two categories:

Covered by Payment of Gratuity Act, 1972	Not covered by Payment of Gratuity Act, 1972
Least of the following will be exempt:	Least of the following will be exempt:
1. Gratuity actually received OR 2. ₹ 20,00,000 – Exempt earlier* OR	1. Gratuity actually received OR 2. ₹ 20,00,000 – Exempt earlier* OR
3. $\frac{15 \text{ days}}{26 \text{ days}} \times \text{Last drawn Salary} \times \text{Each completed year of service or a part thereof in excess of 6 months}$ <i>(7/26 for seasonal employment)</i>	3. $\frac{1}{2} \times \text{Avg. monthly salary based on salary of last 10 months salary} \times \text{Each completed year of service (any excess thereof shall be ignored)}$
POINTS TO NOTE: <ul style="list-style-type: none"> • Meaning of ‘Salary’: Salary here, means Basic Salary + Dearness Allowance (whether forms part of Retirement Benefits or not). • Salary last drawn: means one month’s salary as above i.e. Basic Salary + Dearness Allowance for a period of one month upto the date of retirement. 	POINTS TO NOTE: <ul style="list-style-type: none"> • Meaning of ‘Salary’: Salary here, means ‘Basic Salary’ + Dearness Allowance (only forming part of Retirement Benefits) + Commission based on fixed % of turnover achieved by the employee. • Salary of last 10 months: Actual Salary as above of last 10 months, immediately preceding the month of retirement. (The month in which employee retires, shall be ignored while calculating last 10 months’ salary)

*Gratuity received by the employee in earlier year(s) from his former employer(s) shall be deducted from the aforesaid limit of ₹ 20,00,000.

NOTE: As per the amendment made under the Payment of Gratuity Act, 1972, the limit of exemption of gratuity for employees covered under Payment of Gratuity Act, 1972 has been increased from ₹ 10,00,000 to ₹ 20,00,000. Thereafter, vide Notification No. 16/2019 dated 08.03.2019, the Central Government has increased the limit to ₹ 20,00,000 in respect of employees NOT covered under the Payment of Gratuity Act, 1972 also.

Pension [Sec. 10(10A)]:

Salary Income

Pension is a payment made by the employer after the retirement/death of the employee as a reward for past services. There are two kinds of Pension:

Uncommuted pension: It is a monthly or periodical pension received by an employee after his retirement from his employment. It is taxable for both Government employee as well as Non-Government employee.

Commuted pension: It is a lump sum payment in lieu of periodical payment.

- **For Government employee:** Fully exempt.
- **For Non-Government employee:** Exemption will be as follows:
 - 1) For those employees who are in receipt of gratuity – 1/3 of the total pension.
 - 2) For those who are not in receipt of gratuity – 1/2 of the total pension.

Leave Salary [Sec. 10(10AA)]:

Salary paid to the employee equivalent to the unutilized leave standing to his credit is **called leave salary**.

- If leave salary is encashed while employee is in service, it is taxable for both Government employee and Non-Government employee.
- But if it is encashed after or at time of retirement,
 - **For Government employees:** Fully exempt
 - **For Non-Government employees:** Least of the following is exempt:
 - (1) Actual leave salary,
 - (2) ₹ 3,00,000 – Amount exempt earlier,
 - (3) 10 months average salary × 10 months,
 - (4) 10 months average salary × balance leave standing to the credit of employee

Calculation of balance leaves standing to the credit of employee.

Duration of service in number of years (ignore fraction)
× Earned leave per year (maximum 30 days or 1 month per year)	<u>.....</u>
Total leave earned
Less: Total leave availed	<u>(.....)</u>
Leave standing to the credit of employee	<u>.....</u>

Balance leaves standing to the credit of employee

= Leave standing to the credit of employee ÷ 30 (only if calculated in days).

POINTS TO NOTE:

- Leave salary paid to the **legal heirs of the deceased employee** for the leave standing to the credit of such employee at the time of his/her death is **not taxable**.
- **‘Salary’** here means G.D.
 - = Basic salary + Dearness allowance (D.A.) only if it forms part of retirement benefits,
 - + Commission based on fixed percentage of turnover achieved by the employee.
- **Average salary of last 10 months:** Actual Salary as above of last ten months, immediately preceding the month of retirement. (The month in which employee retires, shall be ignored while calculating last 10 months’ salary).

Retrenchment Compensation [Sec. 10(10B)]:

Least of the following will be exempt from tax:

- (i) Actual amount received;

- (ii) ` 5,00,000 (as specified by the Central Government); or
- (iii) Amount calculated u/s 25F of Industrial Disputes Act, 1947
i.e. 15 days average pay x completed years of service and part thereof in excess of 6 months.

‘Average pay’ means average of the wages payable to a workman:

- in case of monthly paid workman, in the 3 complete calendar months;
 - in case of weekly paid workman, in the 4 complete weeks;
 - in case of daily paid workman, in the 12 full working days,
- preceding the date on which the average pay becomes payable if the workman had worked for 3 complete calendar months or 4 complete weeks or 12 full working days, as the case may be, and where such calculation cannot be made, the average pay shall be calculated as the average of the wages payable to a workman during the period he actually worked.

Wages means all the remuneration capable of being expressed in terms of money payable to a workman including:

- such allowances including DA as the workman is for the time being entitled to;
- the value of any house accommodation or supply of light, water, medical attendance or other amenity or of any other service or of any concessional supply of foodgrains or other articles;
- any travel concession; and
- any commission payable on the promotion of sales or business or both.

However, it does not include:

- bonus;
- contribution to a retirement benefit scheme;
- gratuity payable on the termination of his service

Voluntary Retirement Scheme (VRS) [Sec. 10(10C)]:

Least of the following will be exempt from tax:

- Actual amount received;
- ` 5,00,000 (as specified by the Central Government); or
- Salary at the time of retirement multiplied with 3 months for each completed years of service; OR remaining months of service, if VRS was not taken, whichever is lower.

Salary for the purpose of 10(10C) = Basic Salary + Dearness Allowance, only forming part of Retirement Benefits + Commission based on fixed % of turnover achieved by employee.

Note: Where exemption u/s 10(10C) has been allowed in any assessment year, then no exemption thereunder shall be allowed in any other assessment year to the assessee.

Guidelines [Rule 2BA] for claiming exemption of VRS:

Following are the guidelines of the government for claiming the exemption from tax on VRS:

- (i) It applies to an employee, who has completed 10 years of service or 40 years of age;
This requirement shall not be applicable to an employee of a public sector company for the amount received by him under the scheme of voluntary separation, framed by such public sector company.
- (ii) It should apply to all the employees (by whatever name called) including workers and executives of a company or of an authority or of a co-operative society, as the case may be, except Directors of a company or of a co-operative society;

- (iii) The scheme of voluntary retirement or voluntary separation should have been drawn to result in overall reduction in the existing strength of the employees;
- (iv) The vacancy caused by the voluntary retirement or voluntary separation is not to be filled up;
- (v) The retiring employee of a company shall not be employed in another company or concern belonging to the same management;
- (vi) The amount receivable on account of voluntary retirement of the employee shall not exceed:
 - (a) the amount equivalent to 3 months salary for each completed year of service; or
 - (b) salary at the time of retirement multiplied by the balance months of service left before the date of his retirement on superannuation.

Tax on Non-monetary Perquisites paid by the employer [Sec. 10(10CC)]:

Any tax on the non-monetary perquisites, if paid or borne by the employer as per sec. 192(1A), shall be **exempt in the hands of the employee**. For Details refer the Topic 'Tax deducted and collected at source'

Provident Fund:

Statutory Provident Fund (SPF): It is set up under the provisions of the Provident Funds Act, 1925 and is maintained by Government, Semi-Government organizations, local authorities, railways, universities and recognised educational institutions.

Recognised Provident Fund (RPF): It is a provident fund scheme to which the Employee's Provident Fund and Miscellaneous Provisions Act, 1952 applies, or a fund which is approved by the Commissioner of Income tax.

Unrecognised Provident Fund (URPF): A provident fund which is not recognised by the Commissioner of Income-tax is known as unrecognized provident fund.

Public Provident Fund (PPF): It is the fund set up by the Central Government in which any member of the public can participate by opening a provident fund account at any branch of State Bank of India or its subsidiaries or a few nationalized banks.

Particulars	Statutory Provident Fund (S.P.F)	Recognized Provident Fund (R.P.F)	Unrecognized Provident fund (U.R.P.F)	Public Provident Fund (P.P.F)
At the time of Contribution				
• Employer's contribution	Exempt	Exempt upto 12% of G.D.	Exempt	Employer does not contribute
• Interest on employer's contribution	Exempt	Exempt upto 9.5% p.a.	Exempt	N.A.
• Deduction u/s 80C	Available on employee's contribution	Available on employee's contribution	Not available	Available on account holder's contribution
On Withdrawal				
• Employer's contribution and Interest on employer's contribution	Exempt u/s 10(11)	Exempt u/s 10(12) subject to conditions as below.	Fully taxable as 'Salaries'	Exempt u/s 10(11)
• Employee's contribution			Not an Income	

• Interest on Employee's contribution			Taxable as 'Income from other sources'	
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Conditions for Exemption for accumulated balance withdrawn from RPF:

As per Rule 8 of Part A of the Fourth Schedule, the accumulated balance due and becoming payable to an employee participating in a recognised provident fund shall be exempt:

- (i) If the employee has rendered continuous service with his employer for a period of 5 years or more, or
- (ii) If, though he has not rendered such continuous service of 5 years, the service has been terminated (a) by reason of the employee's ill health or (b) by the discontinuance or contraction of the employer's business or (c) due to any other cause beyond the control of the employee, or
- (iii) If, on the cessation of his employment, the employee obtains employment with any other employer, to the extent the accumulated balance due and becoming payable to him is transferred to his individual account in any recognised provident fund maintained by such other employer.

However in a situation mentioned under clause (iii) above for calculating period of service for clause (i) and (ii) above the period for which such employee rendered continuous service under his former employer or employers aforesaid shall also be included.

Approved Superannuation Fund

Approved Superannuation Fund is a scheme of retirement benefits for the employee which is approved by the Commissioner of Income Tax. Its tax treatment shall be as under:

- Employer's contribution shall be exempt upto ` 1,50,000 p.a. per employee. If the contribution exceeds ` 1,50,000 p.a., the excess will be taxable as salary in hands of the employee.
- Employee's contribution is eligible for deduction u/s 80C.
- Interest on accumulated balance is exempt from tax.
- Payment made from the fund on the death or the incapacitated of the employee or the lump sum payment to the employee on his retirement is exempt from tax.

Deductions from Salaries: [Sec. 16]

The following deductions are **allowed from the Gross Salary** under Section 16:

- **Standard Deduction [Sec. 16(i)]**
Standard deduction shall be available of ` **50,000 or the amount of salary, whichever is less.**
- **Entertainment Allowance [Sec. 16(ii)]** (already discussed under allowances)
- **Professional Tax [Sec. 16(iii)]**
Deduction shall be available only in the year in which professional tax is **paid**.
If professional tax is paid by the employer, it shall be **first included in the salary** of the employee as a perquisite and then the same shall be **allowed as deduction** from his gross salary.
But where the employee himself pays the professional tax, then it shall be deducted from the gross salary without adding it to the salary of the employee.

Relief for Salaried Employees [Sec. 89 with Rule 21A]

Where an assessee receives salary for more than 12 months during any financial year or any payment which is a profit in lieu of salary, his income may be assessed at a rate higher than that at which it would otherwise have been assessed. In such cases, the **assessee is provided relief under section 89**. The **procedure for computing the relief is given in Rule 21A** which is as under:

Where salary is received in arrears or in advance

Step 1: Calculate TAX payable for the previous year in which the arrears / advance salary is received:

- (a) On total income inclusive of additional salary.
- (b) On total income exclusive of additional salary.

The difference between (a) and (b) is the tax on additional salary included in the total income.

Step 2: Calculate the TAX payable of every previous year to which the additional salary relates:

- (a) On total income including additional salary of that particular previous year.
- (b) On total income excluding additional salary.

Calculate the total of the difference between (a) and (b) for every previous year to which the additional salary relates.

Step 3: The excess between the tax on additional salary as calculated under step 1 and 2 shall be the relief allowed under section 89. If there is no excess, no relief is admissible.

Where gratuity is received [other than exempt under section 10(10)]:

Relief is available only if the period of service is 5 years or more. The relief is calculated as under:

(a) Where gratuity is paid in respect of past services of 15 years or more.

1. Calculate the tax on total income (including gratuity) in the year of receipt of gratuity and calculate the average rate of tax.
2. Calculate the tax on gratuity applying the average tax rate computed above.
3. Calculate the tax liability by adding 1/3 of the gratuity to the total income of each of the preceding three years and calculate the average rate of tax for each year separately. Further calculate the average of these three average rates.
4. Compute the tax on gratuity at that average rate.
5. The excess, if any, of the tax on gratuity computed at step 2 over step 4 will be the relief allowed.

(b) Where gratuity is paid in respect of past services of 5 years or more but less than 15 years.

The procedure for computation of relief is same except that in step 3 the number of years for calculating average rate of tax shall be taken as 2 instead of 3 and thus $\frac{1}{2}$ of the gratuity will be added in the total income of the preceding 2 years instead of 3 years.

(c) Where the payment is in the nature of taxable compensation received from the employer or former employer at or in connection with the termination of his employment:

Relief will be available only if the following conditions are satisfied:

- (i) Compensation is received after continuous service of not less than 3 years.
- (ii) The unexpired portion of the term of employment is also not less than 3 years.

The procedure for calculating the relief is same as given in Case (a) above.

(d) Where payment is for commutation of pension:

The procedure for calculating the relief is same as given in case (a) i.e. gratuity paid to the employee in respect of services rendered for a period of 15 years or more.

(e) Where the payment is of a nature other than given under Rule 21A(2) to 21A(5) discussed above:

In these cases, the CBDT may, having regard to the circumstances of each case, allow such relief as it deems fit.