

Critical Analysis of Income from salary

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Abstract:

As we know our income tax is complicated due to its various overlapping provisions. For Income Tax purpose income earned by a taxpayer is divided into five heads of income like Income from Salary, Income from House Property, Income from Business or Profession, Capital Gains and Income from Other Source. Each head of income has its own limitations.

The Purpose of the present paper is to point out the shortcomings and difficulties associated with the provisions of salary as a main head of Income. Through this paper researcher has suggested various proposals for simplification of various provisions related to salary income.

Key words: Basic Salary, Allowances, Perquisites, Gratuity, Pension

1. Introduction:

Under Income Tax Act, there are five heads of income like salary, House Property, Business or profession, capital gains and other source. Salary is one of the important head among them. Basic test for chargeability of Income as salary is employer and employee that is master and servant relationship among payer and payee. It is very essential for a payment to fall under the head of 'salaries'. For example Salary of a Member of Parliament is not chargeable under the head "salaries" as a member of Parliament is not a Government employee. According to Section 15 of Income Tax Act the following income shall be chargeable to income tax under the head "salaries". (Singhania, 2015)

- Any salary due from an employer (or former employer) to an assessee in previous year, whether actually paid or not,
- Any salary paid or allowed to him in the previous year by or on behalf of an employer (or a former employer) though not due or before it became due,
- Any arrears of salary paid or allowed to him in the previous year by or on behalf of an employer (or a former employer) if not charged to tax for any earlier previous year.

Here it should be noted that any advance salary, once included in the total income of a person on receipt basis will not be again chargeable to than when the salary becomes due.

2. Meaning of Salary:

For the purpose of income tax the meaning of the term 'salary' is much wider than what it is normally understood. Section 17(1) gives an inclusive definition of salary as:

- i. Wages
- ii. Any annuity or pension
- iii. Any gratuity
- iv. Any fees, commission, perquisites or profit in lieu of or in addition to salary,
- v. Any advance salary
- vi. Any payment received by employee in respect of period of leave not availed by him i.e. leave salary

3. Other Important Points about salary:

1. Salary will be deemed to accrue or arise at a place where services are rendered. If the services are rendered in India and salary on account of such services is received outside India, it will be treated as an income, which is deemed to accrue or arise in India.
2. The income from salary is taxable on 'due' or 'receipt' basis whichever is earlier.
3. According to The Income-tax Act, there is no conceptual difference between the wages and salaries.
4. If an employee gets an extra remuneration from his employer for some additional work not related to his regular work still that amount is taxable as income from salary.
5. Salaries and professional income must be clearly understood and separated. For e.g. consulting fees received by a doctor in his dispensary is professional income but if he is employed in hospital then consulting fees are taxable as income from salary.
6. Remuneration received from person other than the employer would be taxable under the head "income from other sources".
7. Payment made by an employer to his employee after the cessation of his employment is also taxable under the head "salaries".
8. Pension received by an employee after his retirement is taxable as salary, but any family pension received by the spouse is taxable under the head "income from other sources"

4. Computation of Income from Salary :

Salaries		***
Allowances		***
Perquisites		***

Gross salary		****
Less: Deductions under Section 16		
Entertainment Allowance	***	
Profession Tax	***	***
Income From Salaries		***

5. Complications regarding computation of Income from Salary:

The computation of taxable amount of income from salary becomes difficult due to the complications in the provisions related to computation of taxable income from salary due to following complicated provisions:

5.1 Different meanings of 'salary' –

Term 'Salary' has been used with different meanings in computation of exemptions and taxable value of perquisites. Following are some examples:

i. For computing exemptions under:

- a) leave encashment;
- b) gratuity in the case of a non-Government employee who is not covered under the
- c) Payment of Gratuity Act, 1972;
- d) house rent allowance u/s 10 (13A)
- e) employer's contribution to the recognized provident fund of an employee,

Salary = Basic salary + Dearness Allowance (if the terms of employment so provide) + commission(if it is payable at a fixed percentage on the turnover achieved by an employee)

ii. For computing the value of rent free unfurnished house or the value of concession in the matter of rent in respect of the housing accommodation provided by a non-Government employer to his employee :

Salary = Basic salary + dearness allowance(if terms of employment so provide) + Bonus + commission + fees + taxable amount of the allowances + any other monetary payment which is chargeable to tax and which is not in the nature of perquisite

iii. For computing deduction of entertainment allowance in the case of Government employee's u/s 16(2).

Salary = Basic Salary

iv. for computing exempt amount of gratuity in the case of non-Government employees who are covered under the Payment of Gratuity Act, 1972.

Salary = Basic salary + Dearness Allowance

v. For calculating the amount of deduction available to Central Government employee or any other employer who has joined service on or after January 1, 2004 in respect of contribution to the notified

pension scheme is computed @ 10% of the 'salary' of the employee in respect of contribution made by both, the employer as also the employee.

Salary = Basic salary + Dearness Allowance (if the terms of employment so provide)

Suggestion:

To remove the difficulty of different meaning of salary, researcher is suggesting to include only Basic Salary and Dearness allowance as the components of salary. If we go through the details of salary then we will observe that basic salary and dearness allowance components form major part of salary and hence by excluding other components like commission or taxable other allowance, amount of exemption or taxable value will not affect considerably. So salary must include only Basic salary and Dearness allowance.

5.2 Different meanings of "average salary"–

The term 'average salary' has been used in the following two different ways:

- i. 'Average salary' is computed on the basis of average salary drawn during the period of 10 months immediately preceding the month of retirement for computing the exempt amount in the case of non-Government employees as regards : (a) leave encashment and (b) gratuity when the employee is not covered under the Payment of Gratuity Act, 1972.
- ii. 'Average Salary' is computed on the basis of average of total wages received for a period of 3 months immediately preceding the month of termination of employment of a piece-rated employee covered under Payment of Gratuity Act, 1972 for computing exempt amount of gratuity.

Suggestion:

Here researcher wants to suggest to consider three months period rather than ten months period for average salary. As period and date of increment is common and annual in many organisations for all employees. So it is suggested to consider the period of three months. Due to uniform policies three or ten months will not affect marginally on amount of exemption.

5.3 Distinction between "year of service" and "completed year of service" as regards gratuity:

One of the conditions for computing the exempt amount of gratuity in the case of employees covered by the Payment of Gratuity Act, 1972, as per section 10(10) (ii) of the Income-tax Act, 1961 is—"15 days' salary based on salary last drawn for each year of service". However, in the case of a non-Government employee who is not covered under the Payment of Gratuity Act, 1972, this condition becomes—"half month's average salary for each completed year of service".

Suggestion:

In order to make the law uniform on this part without affecting the interest of revenue on both the parts, simple mathematics rule of round off that is more than six months of service will be counted as full year of service is suggested.

5.4 Discrimination between Government employees and non- Government employees:

Discriminatory provisions in computing taxable income of Government employees and non-Government employees are without any real justification.

It is found that following retirement benefits to Government employees are wholly exempt from tax

- a. amount received as death-cum retirement gratuity by Government employees under section 10(10)
- b. amount of commuted pension under section 10(10A)
- c. amount received as cash equivalent of leave salary as per section 10 (10AA)

But the amounts received by a non-Government employee in respect of all the above three cases are only partly exempted.

Suggestion:

The above discrimination in favour of the Government employees as compared to non-Government employees would have been justified if government employees are getting lesser salaries as compare to non-Government employees. Rather than there are various positive factors like job security, better medical facilities, standard working hours, etc. in Government jobs. So such discrimination is not advisable.

5.5 Classification of employees as specified and non - specified

Following are specified employees:

- i. An employee who is a director in the employer company.
- ii. An employee who has substantial interest in the employer company if he is beneficial owner of equity shares carrying 20% or more voting power in Employer Company.
- iii. An employee whose income chargeable under the head “Salaries” exceeds Rs. 50,000/- (For computing the sum of Rs. 50,000 all non-monetary benefits and all monetary benefits not taxable under section 10 are excluded)

Any employee, other than a specified employee is a “**non - specified**” employee.

The following perquisites provided to an employee by his employer are taxable only in the case of 'specified' employees and are exempt in the hands of non-specified employees:

- a) Service of a sweeper, gardener, watchman or personal attendant;
- b) Supply of gas, electricity or water for household purposes;
- c) Education facility to employee’s family members ;
- d) Leave travel concession (other than the case of twice in a block of four years);
- e) Medical facility for treatment in a private hospital for which the expense of the employer exceeds Rs. 15,000 in a year,
- f) Car or any other automotive conveyance; and
- g) Transport facility by a transport undertaking other than railways and an airline.

Suggestion:

Classification of employees as specified and non - specified employee does not have much practical utility. In current situation large employees are specified employees as minimum wages paid under Payment of Wage Act are also exceeding Rs. 50,000 per annum. So it is advisable to remove such differentiation for the purpose of taxation.

5.6 "population Criteria" for valuation of rent free house:

Provision of rent free accommodation or accommodation at a concession by an employer to his employee is a perquisite which is taxable in the hands of all employees on the basis of following valuation rules.

(A) If accommodation provided is unfurnished:

- a. For the Government employees- the actual rent payable as per the Government rules
- b. For Private and other employees -

Accommodation City	Accommodation owned by employer	Accommodation not owned by employer
1)Having population more than 25 lacs as per 2001 census	15% of salary	Amount of lease rent paid or payable or 15% of salary whichever is lower
2)Having population below 25 lacs but more than 10 lacs as per 2001 census	10% of salary	Amount of lease rent paid or payable or 15% of salary whichever is lower
3)Any other city	7.5%of salary	Same as above

(B) Where the accommodation provided is furnished—

Step No. 1: Find out the value of perquisite as if it is unfurnished accommodation

Step No. 2: Add 10% of original cost of furniture or actual hire charges to the amount as calculated above

(C) The accommodation at a concessional rate—

Step No. 1: Find out value as stated above as if it is provided as free of cost

Step No. 2: Deduct the rent or charges recovered from employee

For valuation of the perquisite salary includes:

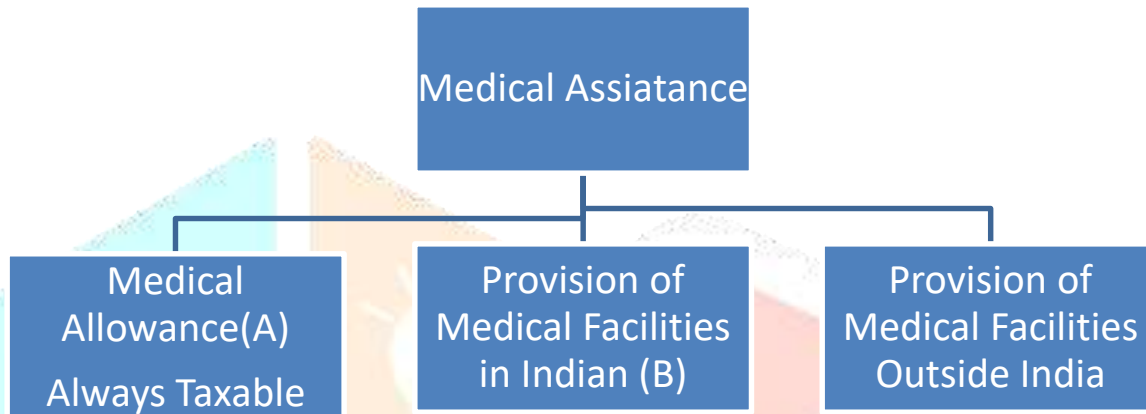
- i. Basic Salary, Dearness Allowance (if the terms of the employment so provide) .Bonus, Commission .Fees, all other taxable allowances
- ii. But it excludes all other perquisites and non-monetary benefits.

Suggestion:

Population based valuation of accommodation is making provisions more complicated. In different provisions like House Rent Allowance exemption u/s 10 (13A) governments is assuming that part of rent in total income is approximately 10% of income. Here researcher is requesting government to make valuation based on simple provision of 10% of basic salary as taxable value of perquisite.

5.7 Monetary limits regarding exempt amount of medical facility:

The facility of medical treatment provided by an employer to his employees and their family members are considered as follows:



1. When the hospital, nursing home, dispensary or clinic where the treatment is done, is maintained by the employer, expenditure incurred by the employer is exempt in full;
2. When the hospital, etc. is maintained by the Central/State Government, local authority or any other person approved by the Government for the treatment of its employees, expenditure incurred or reimbursed by the employer is exempt in full
3. When medical facility is provided in private hospital then amount reimbursed exceeding Rs. 15,000 is taxable.
4. When health insurance policy is obtained by the employer and medical insurance premium is paid or reimbursed by the employer in respect of group medical insurance for employees and/or their family members is not taxable in the hands of employee
5. When medical treatment of the employee or any member of the family of the employee is done outside India, any expenditure incurred by the employer or reimbursement of expenditure incurred by the employee shall be exempt from tax to the extent permitted by the RBI in the cases of:
 - (a) medical treatment of employee or any member of his family outside India; and
 - (b) cost of stay abroad of the employee or any member of the family for medical treatment and cost of stay of one attendant who accompanies the patient in connection with such treatment.

Here, hospital includes any dispensary, clinic, nursing home etc. Medical treatment may be provided to the employee himself or any other member of his family where family means this spouse and children of employee and dependent parents, brothers and sisters of the employee.

Suggestion:

As we are aware of the increasing cost of medical expenses the current exemption limit of Rs. 15,000 is not sufficient to cover basic expenses. So researcher hereby suggests to increase such limit to Rs. 50,000 at least.

Conclusion:

There are many more areas where simplification is required. If government implement above suggestions then salary as a basic head of income will get simplified and purpose of simplification of tax will be achieved to some extent.

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