Class – B.Com II
Subject - Income tax
Topic - Provisions of Income tax regarding retirement benefits to a salaried person

Prepared for class-room teaching by – Dr. S.K. Agarwal
Associate Professor
Deptt. of Commerce
D.N. College, Meerut

Refence Books – Income tax Law & Accounts – Dr. B.K. Agarwal – Nirupam Sahitya Sadan
– Income tax Dr. H.C. Mehrotra – Sahitya Bhawan Pub.

Provisions of Income tax Act regarding Retirement Benefits to a salaried person

Retirement means when a person has completed his full length of service or gets voluntary retirement or is retrenched or terminated from the service. A retired person may avail various retirement benefits. Taxable part of such retirement benefits is included in the salary income of such retired person. Some of the retirement benefits are discussed below:-

1. Death-Cum Retirement Gratuity [Sec 10(10)]

Gratuity is a gratuitous payment which is given by the employer to the employee for the services rendered by the employee during the period of employment. It is paid at the time of retirement, ~~regi~~ resignation, termination or death or disablement of the employee. Following are the income tax provisions regarding gratuity

A. For Government Employees Sec 10(10)(i)

(i) It includes Central, state, local government employees excluding the employees of statutory corporations

(ii) The payment is made as per revised pension rules of the central government or the central civil Services Rules, 1972

$\boxed{\text{The amount received is totally Exempt}}$

B. Other Employees - These employees may be divided in two categories -

(i) If the Payment of Gratuity Act 1972 is applicable
(ii) If the payment of Gratuity Act 1972 is not applicable

(i) If the payment of Gratuity Act 1972 is applicable
Sec 10(10)(ii)

Least from the following three is exempt

(a) 15 days salary for each year's service
(b) ₹ 20,00,000
(c) Actual amount of gratuity received

Note:→ In case of employees of seasonal undertaking, 7 days salary will be taken in place of 15 days
→ Service period of more than 6 months will be taken as one year's service
→ Salary means Basic salary + Dearness allowance last drawn by the employee
→ salary of 15 days will be taken assuming 26 days in a month like

$$\frac{(\text{Basic Salary} + DA) \text{ drawn in the last month}}{26} \times 15$$

$\boxed{\text{Taxable Amount = Actual Gratuity Received − Exempt gratuity as above}}$

(ii) ~~If~~ Payment of Gratuity Act 1972 is not applicable see 10(10)(ii)

If in the question, it is not mentioned that ~~the~~ Payment of Gratuity Act 1972 is applicable, ~~that~~ then it will be assumed that Gratuity Act 1972 is not applicable and Least of the following amount will be exempt

(a) $\frac{1}{2}$ month average salary for every completed year of service

(b) ₹ 10,00,000

(c) Actual amount of gratuity received

Note: → Average ~~Av~~ salary means the average of ~~salary~~ 10 months salary just preceding the month ~~in which~~ of retirement

→ Salary for this purpose will include = Basic salary + Dearness Allowance / Dearness pay [if it is received under the terms of employment + commission (if it is paid to the employee on fixed percentage basis on sales)].

→ Completed year service means full complete year of 12 months. Partial year will not be considered. Like, if service period is 30 years and 10 months, only 30 years service will be taken for computation.

Key Points regarding Gratuity

(i) → If gratuity is received during service period, it will not be exempt.

→ If gratuity is received from more than one employer, standard exempt limit of ₹ 1000000 or ₹ 2000000 will remain the same for all.

→ If the employee has already availed the exemption from previous employer in previous job, now the standard exempt limit will be reduced by the amount which was exempt earlier.

→ If due to death of employee, the gratuity is received by legal heirs of employee, it will be remain exempt in the hands of legal heirs.

Pension [Sec 10(10A)]

(i) If Pension is received monthly or periodically

This amount received by all employees [whether Government employee or Non-Government employee] is taxable

(ii) Commutation of Pension

The employee may have an option ~~for~~ commutation of some part of the periodic pension. for this, that may receive a lump sum amount ~~for~~ that ~~pension~~ part of pension. Following are the provisions of income tax regarding commuted value of pension

(a) For Goverment Employees (Central or State), employees of Local authority or Statutory Corporation or Public Sector undertaking or teachers of an aided college, judges of Supreme Court or High Court

Entire commuted value of Pension is exempt.

(b) For Non-Government Employees

If it is received with Gratuity

Commuted value of $\frac{1}{3}$ of the pension is exempt

If it is received without Gratuity

Commuted value of $\frac{1}{2}$ of the pension is exempt

(iii) If commuted value is received from the fund setup by LIC or any other insurer under pension scheme approved by IRDA

Full amount is exempt

(iv) Notified Pension scheme (NPS)

For Employees joining service on or after 01.01.2004, a new pension scheme has been introduced as NPS

→ employee contribution (10% of his salary) shall be deductible u/s 80CCD(1)

→ Employer's contribution first shall be included in the salaries of employee such contribution is deductible u/s 80 CCD(2) to the extent of 14% of salary in case of ~~Govt~~ central Govt employee and 10% in case of other employee

→ Deduction u/s 80C, 80CCC and 80CCD(1) is allowed to the extent of ₹ 1,50,000.

→ The employee or any other individual can contribute an additional amount upto ₹ 50000 towards NPS which can be claimed as deduction ~~of~~ u/s 80 CCD(1B).

Encashment of Earned Leaves [Sec 10(10-AA)]

Earned leaves means the leaves for which the employee is entitled to avail. Sometimes, the employee does not avail the leave and gets encashment against these leave. It is encashment of earned leaves. The income tax provisions regarding these encashment is as under —

(A) If leaves are encashed during the Service Period
The entire amount received by employee (whether Government employee or non-government employee) is taxable

(B) If leaves are encashed at the time of retirement or leaving the job voluntarily

1. For Government Employees (Central or state Government employees)
Entire amount of encashment is fully exempt from tax

2. For Non-Government Employees (including employees of statutory corporation or local body)
Least of the following will be exempt

(a) Actual amount of encashment of earned leaves received

(b) Encashment of earned leaves not availed by the employee (not exceeding 30 days for each completed year of service) × Average salary of 10 months

(c) Salary of 10 months (first preceeding 10 months from retirement)

(d) ₹ 300,000 (Maximum exemption applicable)

Least from the above a, b, c or d will be exempt

Taxable = Actual Amt received − Exempt amount

(C) Encashment at termination of Service
Entire amount received is Taxable

Note: → Salary means salary plus DA (If it is under the terms of employment plus commission (If is paid at fixed percentage of sales to the employee

→ Average Salary of 10 months means the average of 10 months just preceeding the date of Retirement

→ If the employee has availed the encashment from previous employer, Now the maximum exemption amount would be reduced by the amount of the exemption earlier availed.

→ If due to death of employee, the leave salary is paid to the legal heirs, the amount ~~will~~ is not taxable.

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Retrenchment Compensation [Sec 10 (10-B)]

This Compensation may be received by employee under the Industrial Dispute Act 1947 or under any other Act or Rules, orders or notification. The amount of compensation should not be less than ₹ 50000.

Least of the following is exempt

(i) 15 days average salary for completed year of service

(ii) ₹ 500000 [If worker is retrenched on or after Jan 1, 1997]
Amount notified in Gazette

(iii) Actual amount received

Least from the above is exempt

Taxable = Actual amount received − Exempt amount

Note: → Period of more than 6 months will be assumed a completed year

→ Average salary mean average salary of 3 completed Calender ~~cal~~ months first preceeding the date of compensation becomes payable

If salary is paid weekly then average of 4 completed weeks first preceedig the date of compensation become payable will be taken

If salary is paid daily then average of 12 full workup days will be taken

→ Here, salary includes salary, all allowances, all perquisites, any leave travel compensation. But it will not include Bonus, gratuity and any contribution to retirement benefit scheme

→ If compensation is received by employee under any scheme approved by central Government the above limit shall not apply

Compensation on voluntary Retirement [see 10 (10-C)]

If the employee receive compensation on the voluntary retirement under the scheme of voluntary retirement, then least from the following is exempt amount

(a) Actual amount of Compensation received

(b) 3 months salary for each completed year of service

(c) Salary at the time of retirement × remaining months of service left

(d) ₹ 5,00,000

Least from the above a, b, c, or d is exempt

Taxable Amt = Actual compensation received − Exempt amount

Note

→ Completed year of service mean full complete year, partial year or say months will not be considered

→ Salary means = Basic salary at retirement + D.A (If it is under the terms of employment + Commission (If it is at fixed percentage of sales by employee)

→ This exemption is available only if the compensation amount is received in lumpsum (one time payment) not a periodic payment

→ If the employee has already availed the benefit of voluntary retirement scheme, no further benefit will be available i.e. the exemption is available only for one assessment year.

→ This scheme is available only if the employee has completed 10 years of service or completed 40 years of age and the vacancy caused by voluntary retirement will not be filled up and the retiring employee will not be employed in another company of the same management