Anomalies in Taxation of Salary Income in India

Salaried class is considered the most regular Income Tax payers, given the nature of this class to avoid hassles, transparent nature of income and stringent provisions of TDS. However, there are certain anomalies in the provisions taxing salary income in India which need to be addressed. First is the need to restore Standard Deduction earlier allowed u/s 16 (i) of the Income-tax Act, 1961 to consider the incidental expenses incurred by them. Second is to allow deduction for Conveyance Expenses and House Rent paid whether any allowance is paid to them for this purpose or not. Third is the upward revision of exemption for Education/Hostel Allowance for children of employees. Fourth is to make provision for deducting amount, if any, recovered from outgoing employees in lieu of notice period from taxable income. Fifth is providing an option to retiring employees to keep their PF accumulations in a Fund and the Sixth is abandoning the idea of taxing withdrawals from PF forever. Read on to know more…..

Salaried class assessees are considered to be the most regular Income Tax payers in India. Since most of them like hassle free life, they don't want to take any risk of getting notices from the Income Tax Department and approaching experts to get these replied. Hence, they pay the tax even when there is some confusion as to whether it is actually payable or not. Moreover, the transparent nature of the source of their income and stringent provisions of TDS do not leave chances of any doubt regarding payment of due taxes in respect of income from salary.

Surprisingly, salaried class has to pay tax on almost their entire gross salary income, as they have only a few options for tax saving, like getting a portion of their pay packet as House Rent Allowance (HRA) or Transport Allowance *etc.* As regards deduction for investments made which are eligible u/s 80C, payment against Medical Insurance Premium u/s 80D, payment of House Rent u/s 80GG *etc.*, these are available to all assessees whose income may be taxed under any head and hence, cannot be said to be available to the salaried tax payers only.

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Moreover, if we go through the provisions of the Income-tax Act, 1961 along with the Income Tax Rules, 1962 (referred to as the 'Act' and the 'Rules' respectively hereinafter in this Article) regarding taxing of salary income, we will find certain anomalies which need to be addressed, keeping in view of not only the overall contribution of salaried class in the revenue from Income Tax but also to make these provisions appear 'Just' and 'Equitable'. These anomalies or inconsistencies may be discussed as under –

1. No rebate for incidental expenses

Under all the heads of Income except Salary, incidental expenses incurred by the assessees to earn the income being subjected to tax are deducted for the purpose of calculation of income taxable under that head. For example, in the case of Income from House Property, a Standard Deduction @ 30% of the annual value is allowed in addition to municipal taxes paid, (apparently towards other expenses in connection with the concerned house property like repairs, insurance *etc.*), apart from interest on borrowed capital u/s 24 of the Act.

In the case of Business Income, deduction for such expenses is allowed (unless the income is 'deemed' under certain provision of the Act, like determination of profits or gains of business of plying, hiring or leasing goods carriages u/s 44AE of the Act) under provisions of Section 28 to 44 of the Act. Regarding Income from Capital Gains, since the taxable income is ascertained after deducting cost of acquisition of capital asset from the transfer value thereof, the expenses incurred to earn such income are automatically considered. In the same manner, while computing taxable Income from Other Sources, deduction for such expenses is allowed u/s 57 of the Act.

However, no such deduction is allowable in case of Salary Income, though the salaried persons also have to incur certain expenses to earn salary, like on purchasing of books and periodicals, obtaining membership of professional bodies, attending seminars to update their knowledge, joining certain courses, preparing for and appearing in certain examinations to get promotions in their existing jobs or finding better jobs, making payment to placement agencies to find a new job (though many such agencies charge fee from the employers only, still some to charge it from both sides) *etc.*

There is a strong case that this deduction should be restored on the grounds of justice, equity and fairness, to put the salaried class at par with other assessees (in view of the provisions of Article 14 of the Constitution of India, guaranteeing all, equality before the law), which may be fixed, say @ 5% of Gross Salary Income, subject to maximum ₹ 30,000/- in a year.

Since it is difficult to assess the quantum of such expenses in each individual case, a portion of Salary Income was being allowed earlier as 'Standard Deduction' u/s 16 (i) of the Act on uniform basis but it was withdrawn later w. e. f. the Assessment Year 2006-07. Accordingly, there is a strong case that this deduction should be restored on the grounds of justice, equity and fairness, to put the salaried class at par with other assessees (in view of the provisions of Article 14 of the Constitution of India, guaranteeing all, equality before the law), which may be fixed, say @ 5% of Gross Salary Income, subject to maximum ₹ 30,000/- in a year.

2. Undue condition of getting specified amount as allowance from the employer for claiming deduction for certain expenses

There are certain provisions in the Act, restricting deduction for certain expenditure incurred by the salaried assessees, to the condition that they must be in receipt of allowances of the specified nature from their employers. This condition seems to discriminate between the employees who are getting allowances from their employers as such and those who are not getting these. In fact, getting an allowance from employer or not depends on the pay structure of the employer and is not in the hands of an employee. Though some employers give the liberty to their employees to bifurcate their agreed pay packets into as many elements as they want to reduce their tax burden, however, most of the employers adopt a uniform pay policy so as to avoid dissatisfaction among the rank and file of their employees and also to rule out the chances of complications resulting from such liberty being given to the employees.

Actually, incurring of such expenditure by the assessee does not depend on the fact whether an allowance is being paid by the employer or not. If these expenses are to be incurred by an employee,

these are to be, whether the employer pays any such allowance or not. Since these expenses are incurred by the employees in connection with their employment, the criteria of employees getting something as allowance from their employers for claiming deduction must be done away with, while retaining only the condition of incurring the specified expenditure. Two provisions of this nature are being discussed here below-

A. Transport Allowance

Presently, if an employee is getting any payment from his employer as Transport Allowance to meet out his expenditure for the purpose of commuting between place of his residence and the place of his duty, a sum up to ₹1,600/- per month is exempted out of it u/s 10 (14) read with Rule 2BB. However, if he is not getting any amount from his employer as such, he cannot claim any exemption on this score, though, both these class of employees have to incur the same amount of expenditure towards conveyance. It, therefore, seems to be quite logical that this deduction should be allowed to all employees who do not reside in the office/factory campus and have to travel by conveyance from residence to work place (whether in public transport or by an owned vehicle, maintained by them mainly for this purpose, for which they cannot even claim depreciation) except in case where the conveyance is provided by the employer.

In fact, this expense should be allowed as an incidental expense incurred to earn salary income as a fixed portion of salary (with a ceiling of course) as the amount incurred by an employee for this purpose normally varies in proportion to his salary income. For example, an employee residing in Delhi at a distance of about 15 km from his work place and earning about ₹5.00 lakh per annum, would like to travel by Auto and/or Bus/Metro or would maintain a two wheeler for this purpose and may have to spend ₹70-80 per day on these (or ₹22500/- per annum, for 300 working days in a year @ ₹75/- per day on average basis), whereas an employee earning more than ₹5.00 lakh per annum may like to travel by his own car for which he may have to incur a sum of ₹150/- per day, @ ₹5/- per km. for a to & from distance of 30 km. (or ₹45,000/- per annum, @ ₹150/- per day for 300 working days in a year on average basis).

Hence an employee, not residing in the campus of his work place and also not provided with conveyance facilities by his employer, must get an extra deduction on account of Conveyance Expenses as a percentage of his gross salary income which may be fixed for metro cites, say @ 5%, subject to maximum of ₹30,000/- and for other cities @ 2.5% subject to maximum of ₹15,000/-, whether the employee is in receipt of any allowance for this purpose or not.

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B. House Rent Allowance (HRA)

An employee who is specifically granted an allowance (by whatever name called) by his employer to meet expenditure, actually incurred on payment of rent in respect of residential accommodation occupied by him, can claim exemption u/s 10 (13A) read with Rule 2A, to the least of the following, whether he owns any residential accommodation or not–

a) An amount equal to 50% of salary, where the residential house is situated at Mumbai, Kolkata, Delhi or Chennai and amount equal to 40% thereof where the residential house is situated at any other place.
b) HRA received by the employee in respect of the period during which the rental accommodation is occupied by him during the previous year.
c) The excess of rent paid over 10% of salary.

Out of the above three, in most of the cases either it is item b) i.e. HRA received by the employee, or item c) i.e. the excess of rent paid over 10% of salary which is the least, as no prudent person would like to pay 60% or 50% portion, as the case may be, of his salary [after adding 10% in the ceiling mentioned in item a), so as to reduce the same from rent paid under item c), only then the item a) can be equal to or lesser than the item c)]. However, an employee (or any other assessee also) not getting any such allowance at any time

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during the previous year but residing in a rented accommodation, would get a deduction u/s 80GG of the Act in respect of rent paid, if he or his specified relatives do not own any residential accommodation at the place of his work and also if he owns any residential accommodation at any other place but does not claim concession in respect of self occupied house property u/s 23 (2) (a) or 23 (4) (a) of the Act. The amount deductible will be the least of the following -

a) ₹5,000/- (increased from ₹2,000/- under Budget proposals 2016-17) per month.
b) 25% of his total income (excluding capital gains and other specified sums)
c) The excess of rent paid over 10% of total income (excluding capital gains and other specified sums).

From the above, it appears that though the provisions of Section 10 (13A) are more lenient and the deduction allowed is also more in comparison to the exemption allowed u/s 80GG but the former still need revision for the benefit of employees. Since taking a house on rent near work place is incidental to employment, the criteria of HRA being paid to the employee [as mentioned at item b) hereinabove] must be removed while calculating the amount eligible for exemption u/s 10 (13A) read with Rule 2A, though the limit of salary which is equal to 50% and 40% respectively at present [as mentioned at item a) hereinabove] may be revised at a slightly lower level, to rationalise the deduction, if required.

3. No revision in the exemption limit of Children's Education/Hostel Allowance since last about 20 years

An allowance paid by the employer for the education of children of his employee or to meet out their hostel expenditure (by whatever name called) is exempt u/s 10 (14) read with Rule 2BB to the extent of ₹100/- and ₹300/- per month per child respectively in respect of maximum 2 children. However, the amount of these exemptions which was increased from ₹50/- and ₹150/- per month per child respectively w.e.f. 01-08-1997 to present ₹100/- and ₹300/- respectively, has not been revised since last about 20 years. As everybody knows, cost of education has gone manifold during this period, it needs a suitable upward revision, say to ₹500/- and 1500/- per month per child respectively to give some relief to the salaried tax payers.

4. No deduction of the amount recovered by an employer from outgoing employee, against short notice given, before leaving the employment

There are cases where employers make some recovery from the employees leaving an organisation, if the notice given by them for leaving their jobs falls short of the period specified as per terms of their employment. Since under the present Income Tax Law, there is no provision to give credit of such recovery from employees while calculating their taxable Salary Income, the employers cannot do that. On the other hand, in case any reimbursement against such recovery is made to such employees either in full or in part, by their succeeding employers, the amount so reimbursed is added by them to the Salary Income of such employees and taxed as such.

Here the anomalies are –

a) though the previous employer takes back a part of the salary paid to his employee, his salary income is not reduced with the amount recovered for the purpose of calculating his income tax liability. In fact, when anything is recovered from recipient of an income on account of such reasons, the income is automatically reduced to that extent.
b) the employee had to pay this amount to get increased salary (which is normally the case) from his succeeding employer which is again subjected to tax. Hence, not granting deduction for such recovery will also amount to levying tax on an Income without reducing incidental expenses incurred to earn that Income.
c) when the total salary paid by the employer, be it in the form of cash, perquisites or fringe benefits, is being subjected to tax, recovery of some portion from the employee out of that salary should also be reduced from income for the purpose of calculating his income tax liability, otherwise it will amount to levy of 'Tax' without 'Income' as

far as the tax on the amount so recovered by the employer is concerned.

d) the employer who recovers such amount from the outgoing employee, pays Income Tax thereon, as this amount is credited by him in the Salary Paid A/C or in the Other Income A/C, thus reducing his expense or increasing the income, which is subjected to tax. Hence, taxing the same in the hands of the concerned employee, means taxing the sum twice, once in the hands of the employer and then again in the hands of the employee.

Accordingly, to provide justice in such cases, it is quite logical that there should be a provision in the Rules, under which the previous employer has to reduce the salary income of outgoing employees, with the amount recovered from them, if any, in *lieu* of notice period, while calculating their income tax liability. Not only this, if after giving credit for the amount so recovered, the net salary from previous employer shows negative income for that year (such a situation may arise when the employee leaves job at the beginning of a financial year), the employer should give a certificate for that and the amount of such negative income be adjusted from his salary income from next employer. Of course, if the succeeding employer reimburses something towards such recovery, it should invariably be subjected to tax on his part.

5. Non-availability of a suitable investment option before retiring employees

Previously, employees who used to get retired and did not understand the intricacies of the share market or other investment options like buying of an immovable property to earn capital appreciation/ rental income therefrom, used to keep their PF accumulations with the trusts managing PF, from where they continued earning the same rate of interest, they used to get earlier which was also exempt from tax. But from the Financial Year 2011-12, the employees were not getting any interest on their PF accumulations, if they continued keeping their PF accumulations with the PF trust beyond 3 years after retirement.

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The EPFO (Employees Provident Fund Organisation) has now decided to provide interest on such 'Inoperative Accounts' (wherein PF contributions have not been received for 36 months) from 1st April, 2016, which is likely to benefit over 9 crore such account-holders having total deposits of ₹32,000 crore approx.

This was quite unreasonable that a person who continued keeping his hard earned money with the Custodian for use in old age, is abruptly deprived of the benefit of interest on his funds. Fortunately, the EPFO (Employees Provident Fund Organisation) has now decided to provide interest on such 'Inoperative Accounts' (wherein PF contributions have not been received for 36 months) from 1st April, 2016, which is likely to benefit over 9 crore such account-holders having total deposits of ₹32,000 crore approx.

There was another controversy over taxability of interest accrued on PF accumulations after cessation of employment of PF members, when the ITAT (Income Tax Appellate Tribunal) held, in the case of *ONGC Ltd. CPF Trust vs. ITO (2005), 98 TTJ 1111 (Del.)*, that such interest is subject to TDS u/s 194A of the Act, in view of the fact that after cessation of employment, the status enjoyed by the member as 'employee' gets changed and hence the interest accrued on PF accumulations cannot be treated as "Income from Salary', for which 'employer-employee' relationship is necessary. After this decision, many PF trusts started deducting TDS on such interest and the employees (retired, of course) had to bear the consequences. It was again a paradoxical situation, wherein a person's interest income was being treated exempt from tax when he was in earning capacity, but it ceases to be exempt and starts getting taxed after his retirement when he loses the regular source of his income.

Hence, the Government should seriously think over making clear rules to allow retaining of PF accumulations by the retired employees with the trusts and continue treating the interest accrued thereon as exempt, or form a separate fund wherein the retiring employees from any sector, may get their PF accumulations transferred, with assured reasonable return which must be exempt from tax, with an option to get an annuity on monthly basis,

and also to withdraw a specified portion of the original sum in his life time, under certain specified circumstances like illness, marriage of ward *etc*., so that they can get a safe platform to park their money and earn an assured regular income. This is all the more necessary in view of the fact that the coverage under social security schemes in India, is still not sufficient to take care of the citizens in their old age.

6. Proposal to tax the withdrawals out of PF accumulation

Presently, there is no provision in the Indian Income Tax Law for taxing the withdrawals from PF. However, it was being considered by the Union Government since long which resulted into a provision in Budget Proposals 2016-17, to tax a portion of withdrawals from the PF accumulations. Though due to stiff opposition of the proposal by all and sundry and also by intervention of the Prime Minister, the proposal was taken back, however, given the chances of revival of any proposal of this nature in future, it is worth to discuss the pros and cons of the issue–

There are 4 ingredients of Provident Fund accumulations viz. self contribution of employee made over a period of time, interest accumulated thereon, contribution made by the employer and the interest accumulated thereon.

As regards position of own contribution of employee, it cannot be taxed as income because it is deposited by him out of his income which was already subjected to tax. Hence, at the time of withdrawal thereof, it is nothing but the refund of amount invested by the employee and not an income earned by him. Even if it is found taxable as a reversal of deduction already claimed by him on such investment either under the erstwhile Section 88 or the present Section 80C, it will not stand just for retrospective application, as in that case, the employee should have been given an option to avail such exemption or not by making it clear to him that this exemption would be reversed at the time of withdrawal of the amount post his retirement.

Moreover, it may be that the employee might have invested more than the amount eligible for exemption u/s 80C, making it difficult to ascertain, as to against which part of his investment, he actually availed the benefit at first, thus opening a Pandora's box giving rise to filing of number of Court cases. For example, an employee spent ₹40,000/- as Tuition Fee of his daughter/son, paid ₹50,000/- towards repayment of principal amount of Housing Loan taken by him, invested ₹30,000/- as Life Insurance Premium, purchased National Savings Certificates (NSCs) worth ₹20,000/- and deposited ₹60,000/- in PF, in a year. However, against this total amount of ₹200,000/-, he will get deduction u/s 80C for ₹150,000/- only.

The Government should seriously think over making clear rules to allow retaining of PF accumulations by the retired employees with the trusts and continue treating the interest accrued thereon as exempt

Now, at the time of withdrawal of such amount from PF, against which portion of the total investment ₹200,000/-, the assessee would be deemed to have claimed deduction earlier? Even if it is proposed to be considered on proportionate basis, then the amount of tuition fee paid is never going to be received back. Hence, he may claim that he got deduction for full payment made towards Tuition Fee, repayment of Housing Loan, Life Insurance Premium and NSCs purchased, while claiming the remaining ₹10,000/- only against PF contribution.

Now come the other three portions of PF accumulation namely, interest accumulated on own contribution, amount contributed by the employer and the interest accumulated thereon. These should also not be taxed at the time of withdrawal, being not the income of current period but earned gradually from year to year in a long span of time. If these were to be taxed at all, why at first these were exempted? Suppose, instead of getting exemption from tax, these were declared taxable at the initial stage itself, there may be cases where there would be no tax on such income at all, or the tax rate could be lower, given the lower income of the assessees at that time. Moreover, the employee might have resorted to other means of tax saving like obtaining more housing loan *etc*., or the interest could have been exempt under some other section (like 80L was allowing earlier) which he did not claim at that time, as he was not given option to get such income taxed at that point of time.

In this way, considering the contribution of salaried tax payers in the revenue from Tax and their vulnerable position, it is expected that their case would be taken up by the Finance Minister on just, equitable and humanitarian grounds on the lines of suggestions given hereinabove. ■