

## Taxability on Salary Arrears



*Pay Commission is set up by Government of India, and gives its recommendations regarding changes in salary structure of its employees. Since India's independence, seven Pay Commissions have been set up on a regular basis to review and make recommendations. Normally, Revision in Pay Commission happens every 10 years. Pay Commission is for Central Government and for PSB (Public Sector Bank), it is called Bipartite Settlement. Revision on Bipartite agreement happens every five years. The 7<sup>th</sup> Pay Commission became due with effect from 1<sup>st</sup> January 2016 and has been more or less implemented or is under implementation. The 11<sup>th</sup> bipartite settlement became due on 1<sup>st</sup> November 2017. These have or will increase the allowances, salary, and other benefits for the employees thereby also increasing the related tax liability. This article focuses on the aspect of taxability vis-à-vis such revisions in salary structure of the employees. Read on...*

### What is Arrears of Salary?

Under Section 15 of the Income-tax Act, 1961, Salary is taxable when it is due or when it is actually received, whichever is earlier except Arrears on Salary which are usually announced from a back



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date and therefore cannot be taxed when due. Any amount of salary received from present or past employer during relevant previous year and which relates to some earlier previous years, is treated as arrears of salary. It is taxable in the year in which it is received and not the year to which it belongs.

In Current Scenario, Government employees receive their arrear on salary in one assessment year, when an employee receives arrears of salary for the previous years, which was not taxed earlier on due basis, then salary received is taxed on receipt basis. Taxability on such arrear increases substantially as it shifts the Individual to a higher

tax bracket or even leads to charging of surcharge etc. With a view to granting relief to Individual tax payers in such cases, the current income-tax law allows relief under section 89 of the Income-tax Act, 1961.

### What is Relief under Section 89 of the Income-tax Act, 1961?

If an individual receives any portion of his salary in arrears or in advances or receives profit in lieu of salary, he can claim relief in terms of Section 89 read with Rule 21A of the Income-tax Rules, 1962. Computation of relief is being provided in Rule 21A. Rule 21A(1) reads as follows:

*“Where, by reason of any portion of an assessee’s salary being paid in arrears or in advance or, by reason of any portion of family pension received by an assessee being paid in arrears or, by reason of his having received in any one financial year salary for more than twelve months or a payment which under the provisions of clause (3) of Section 17 is a profit in lieu of salary, his income is assessed at a rate higher than that at which it would otherwise have been assessed, the relief to be granted under sub-section (1) of Section 89 shall be...”*

Here’s how you can calculate the tax relief yourself–

**Step 1:** Calculate tax payable on the total income, including additional salary – in the year when it is received.

**Step 2:** Calculate tax payable on the total income, excluding additional salary in the year when it is received.

After knowing the amount of arrears, one needs to calculate the tax over the same.

**Step 3:** Calculate the difference between Step 1 and Step 2.

**Step 4:** Calculate tax payable on the total income of the year to which the arrears relate, excluding arrears.

**Step 5:** Calculate tax payable on the total income of the year to which the arrears relate, including arrears.

**Step 6:** Calculate the difference between Step 4 and Step 5.

**Step 7:** Excess of amount at Step 3 over Step 6 is the tax relief that shall be allowed.

If the amount in Step 6 is more than the amount in Step 3, no relief shall be allowed.

Let us understand this with the help of an example: AS is Bank employee who has received his arrear of salary on account of 11<sup>th</sup> bipartite settlement which is as follows:

Particular	Per Month Salary *AY 2019-20	Per Month Salary AY 2018-19
Basic Salary	60,000	50,000
Dearness Allowance	20,000	17,000
Special Allowance	5,000	3,000
<b>Total Taxable Income</b>	<b>85,000</b>	<b>70,000</b>

With effect from November 1, 2017, 11<sup>th</sup> bipartite settlement is due, and it has been decided to increase 20% on December 31, 2018.

\*Adjustment on account of 11<sup>th</sup> bipartite agreement has already been adjusted in AY 2019-20.

As it involved two Assessment Years, we need to have tax slabs for two years.

#### Income Tax Slab for AY 2019-20

Slabs	Tax Rate	Health and Education Cess
Income up to ₹ 2,50,000	No tax	
Income from ₹ 2,50,000 – ₹ 5,00,000	5%	4% of Income Tax
Income from ₹ 5,00,000 – 10,00,000	20%	4% of Income Tax
Income more than ₹ 10,00,000	30%	4% of Income Tax

#### Income Tax Slab for AY 2018-19

Slabs	Tax Rate	Education Cess
Income up to ₹ 2,50,000	No tax	
Income from ₹ 2,50,000 – ₹ 5,00,000	5%	3% of Income Tax
Income from ₹ 5,00,000 – 10,00,000	20%	3% of Income Tax
Income more than ₹ 10,00,000	30%	3% of Income Tax

# Taxation

(Amount in Rupees)

Assessment Year	AY 2019- 20	AY 2018-19
<b>Income Before Arrears</b>	<b>10,20,000</b>	<b>8,40,000</b>
<b>Tax Liability on the same ( A )</b>	<b>1,23, 240</b>	<b>82,915</b>
<b>Arrears ( 14,000 per Months From Nov 1, 2017 to Mar 31, 2018)</b>	<b>70,000</b>	<b>70,000</b>
<b>Income After Arrears (Income+ Arrears )</b>	<b>10,90,000</b>	<b>9,10,000</b>
<b>Tax Liability on the same ( B )</b>	<b>1,45,080</b>	<b>97,335</b>
<b>Tax liability (B – A)</b>	<b>21,840</b>	<b>14,420</b>
<b>Tax Relief under Section 89 (21,840-14,420)</b>	<b>7,420</b>	
<b>Tax payable for AY 2019-20 (1,45,080-7,420)</b>	<b>1,37,660</b>	

Now let us understand the Calculation for above table.

**Step 1:** Calculate tax payable on the total income, including additional salary for the Assessment Year 2019-20 – in the year it is received. ₹1,45,080

**Step 2:** Calculate tax payable on the total income, excluding additional salary for the Assessment Year 2019-20 in the year it is received. ₹ 1,23,240

After knowing the amount after arrear, you need to calculate the tax over the same.

**Step 3:** Calculate the difference between Step 1 and Step 2. (₹ 1,45,080 - 1,23,240) = ₹ 21,840

**Step 4:** Calculate tax payable on the total income of the Assessment Year 2018-19 to which the arrears relate, excluding arrears. ₹ 82,815

**Step 5:** Calculate tax payable on the total income the Assessment Year 2018-19 to which the arrears relate, including arrears ₹ 97,335

**Step 6:** Calculate the difference between Step 4 and Step 5. (₹ 97,335 – 82,815) = ₹ 14,420

**Step 7:** Excess of amount at Step 3 over Step 6 is the tax relief that shall be allowed.

$$₹ 21,840 - ₹ 14,420 = ₹ 7,420$$

If the amount in Step 6 is more than the amount in Step 3, no relief shall be allowed.

If you consider arrears payment as income for only present financial year, you would be paying ₹ 7420 extra as taxes, without any fault of yours which sound bit illogical. So the income-tax law (section 89) allows you to pay only amount that is payable considering as if you have received that income in

AY 18-19 and has provided appropriate relief for tax payers.

Therefore, AS is eligible to get relief under section 89 for ₹ 7,420. Accordingly, his tax liability will be ₹ 1,37,660.

This Example involves two Assessment years which is most likely applicable for Bank Employees; however, 7<sup>th</sup> Central Pay Commission involves three Assessment Years as it was applicable with effect from January 1, 2016. Let us understand with the help of an Example:

Mr. MV is CPSU Employee who has received his arrear of salary on account 7<sup>th</sup> Pay Commission which is as follows:

AY	AY 2019-20 *	AY 2018-19	AY 2017-18
<b>Particular</b>	<b>Per Month Salary</b>	<b>Per Month Salary</b>	<b>Per Month Salary</b>
<b>Basic Salary</b>	<b>60,000</b>	<b>50,000</b>	<b>40000</b>
<b>Dearness Allowances</b>	<b>2,000</b>	<b>1,000</b>	<b>1000</b>
<b>Other Allowance</b>	<b>24,000</b>	<b>20,000</b>	<b>16,000</b>
<b>Total Taxable Income</b>	<b>86,000</b>	<b>71,000</b>	<b>57,000</b>
<b>Annual Taxable Income</b>	<b>10,32,000</b>	<b>8,52,000</b>	<b>6,84,000</b>

With effect from January 1, 2017, 7<sup>th</sup> Pay Commission is due, and it has been decided to increase 25% on December 31, 2018.

\*Adjustment on account of 7<sup>th</sup> Pay Commission has

### **Income Tax Slab for AY 2019-20**

Slabs	Tax Rate	Health and Education Cess
Income up to ₹ 2,50,000	No tax	
Income from ₹ 2,50,000 – ₹ 5,00,000	5%	4% of Income Tax
Income from ₹ 5,00,000 – 10,00,000	20%	4% of Income Tax
Income more than ₹ 10,00,000	30%	4% of Income Tax

### **Income Tax Slab for AY 2018-19**

Slabs	Tax Rate	Education Cess
Income up to ₹ 2,50,000	No tax	
Income from ₹ 2,50,000 – ₹ 5,00,000	5%	3% of Income Tax
Income from ₹ 5,00,000 – 10,00,000	20%	3% of Income Tax
Income more than ₹ 10,00,000	30%	3% of Income Tax

### **Income Tax Slab for AY 2017-18**

Slabs	Tax Rate	Education Cess
Income up to ₹ 2,50,000	No tax	
Income from ₹ 2,50,000 – ₹ 5,00,000	10%	3% of Income Tax
Income from ₹ 5,00,000 – 10,00,000	20%	3% of Income Tax
Income more than ₹ 10,00,000	30%	3% of Income Tax

Assessment Year	AY 2019- 20	AY 2018-19	AY 2017-18
<b>Income Before Arrears</b>	<b>10,32,000</b>	<b>8,52,000</b>	<b>6,84,000</b>
<b>Tax Liability on the same ( A )</b>	<b>1,26,984</b>	<b>85,387</b>	<b>63,654</b>
<b>Arrears ( 25% Increment From January 1, 2017 to March 31, 2018)</b>	<b>2,55,750</b>	<b>2,13,000</b>	<b>42,750</b>
<b>Income After Arrears (Income+ Arrears)</b>	<b>12,87,750</b>	<b>10,65,000</b>	<b>7,26,750</b>
<b>Tax Liability on the same ( B )</b>	<b>2,06,778</b>	<b>1,35,960</b>	<b>72,461</b>
<b>Tax Liability (B – A)</b>	<b>79,794</b>	<b>50,573</b>	<b>8,807</b>
<b>Tax Relief under section 89(1) (79,794-50,573-8,807)</b>	<b>20,414</b>		
<b>Tax payable for AY 2019-20 (2,06,778-20414)</b>	<b>1,86,364</b>		

# Taxation

Now let us understand the Calculation for above table.

**Step 1:** Calculate tax payable on the total income, including additional salary for the Assessment Year 2019-20 – in the year it is received. ₹ 2,06,778

**Step 2:** Calculate tax payable on the total income, excluding additional salary for the Assessment Year 2019-20 in the year it is received.  
**Rupees 1,26,984**

After knowing the amount after arrear, you need to calculate the tax over the same.

**Step 3:** Calculate the difference between Step 1 and Step 2. (₹ 2,06,778 - 1,26,984) = Rupees 79,794

**Step 4:** Calculate tax payable on the total income of the Assessment Year 2018-19 to which the arrears relate, excluding arrears.  
₹ 1,35,960

**Step 5:** Calculate tax payable on the total income the Assessment Year 2018-19 to which the arrears relate, including arrears ₹ 85,387

**Step 6:** Calculate the difference between Step 4 and Step 5. (₹ 1,35,960 - 85,387) = ₹ 50,573

**Step 7:** Calculate tax payable on the total income of the Assessment Year 2017-18 to which the arrears relate, excluding arrears. ₹ 72,461

**Step 8:** Calculate tax payable on the total income the Assessment Year 2017-18 to which the arrears relate, including arrears ₹ 63,654

**Step 9:** Calculate the difference between Step 4 and Step 5. (₹ 72,461 – 63,654) = ₹ 8,807

**Step 10:** Excess of amount at Step 3 over (Step 6 Plus Step 9) is the tax relief that shall be allowed.

$$₹ 79,794 - ₹ 50,573 - ₹ 8,807 = ₹ 20,414$$

If the amount in (Step 6 + Step 9) is more than the amount in Step 3, no relief shall be allowed.

So, MV is allowed to claim relief under section 89 of ₹ 20,414. Accordingly Tax liability will be amounting to ₹ 1,86,364 for AY 2019-20.

## How to Claim Relief Under Section 89?

After understanding the computation under section 89 of the Income-tax Act, 1961, let us understand how to claim such relief practically while filling Income Tax Return. To claim the benefit of provisions under section 89, filing of Form No.10E is mandatory. In case, taxpayer has forgotten to file Form No. 10E and claimed Relief under Section 89, then he shall be receiving an income tax notice from the Department sooner stating as follows (generally):

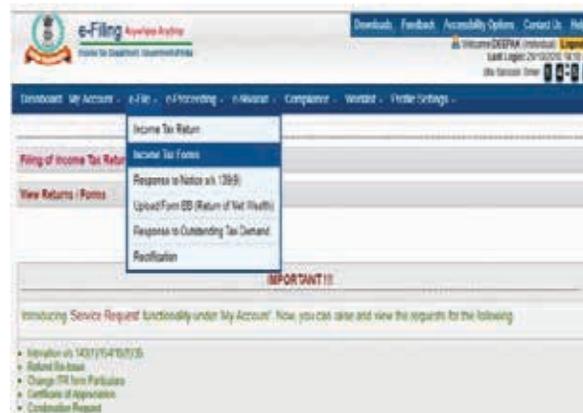
*“The relief under section 89 has not been allowed in your case, as the online form 10E has not been filed by you. The furnishing of Online form 10E is required as per Section 89 of the Income Tax Act”*

Form No. 10E contains 5 Annexure applicable to different types of arrears of Income:

1. Annexure I is for salary received in advance or in arrears.
2. Annexure II is for gratuity received for past services for the period exceeding 5 years but less than 15 years.
3. Annexure IIA is for gratuity received for past services for 15 years or more.
4. Annexure III is for compensation received for termination of employment.
5. Annexure IV is for commuted pension received.

This form can be filed online on the income tax e-filing portal. Following are the steps to fill Form No. 10E online:

1. Login to <https://incometaxindiaefiling.gov.in/> with your User ID and Go to Tab ‘e-File’ - ‘Income Tax Forms’ as shown in the screenshot below:



- Select the option 'Form No. 10E' from Form Name Options, relevant Assessment Year (eg 2018-19) and Submission Mode: Prepare and submit Online as shown in the screenshot below.

- Fill the Necessary details on Tab Menu '10E' and Select the "Annexure I" for Arrear of Salary as shown in the screenshot below:

- Fill the Details in "Annexure- I" regarding your arrears of salary as shown in the screenshot below:

Sl. No.	Description	Amount
001	Tax Payable on Total Income (2)	0
002	Relief u/s 89A	0
003	Tax after Relief (1 - 02)	0
004	CESS u/s 03	0
005	Total Tax & Cess (03+04)	0
006	Relief u/s 89C (Please ensure to submit Form 10E)	0
007	Balance Tax after Relief (05-06)	0
008	Interest u/s 230A	0
009	Interest u/s 230B	0
010	Interest u/s 230C	0
011	Fee u/s 234F	0
012	Total Interest and Fee Payable (07 + 08 + 09 + 10)	0
013	Total Tax, Fee and Interest (06 + 08 + 09 + 10 + 11)	0

- Check your relief amount accordingly and submit the same. Please note that it is mandatory to file Form No. 10E in order to get relief under section 89. After filing of Form No. 10E, the next step is to claim such relief in the ITR Form. The amount of relief calculated by

Form No. 10E is to be mentioned under 'Tax Relief' column under Tab 'Computation and Income Tax' of the ITR form as shown Below:

- Your Tax liability will be decreased by the amount claimed under section 89.

### Key Points to Remember before Filing of Income Tax Return:

Most of the central government and public sector bank employees received or will be receiving arrears of salary in the assessment Year 2019-20. It is important to consider following points before filling Income Tax Return:

- Salary is taxable when it is due or when it is actually received, whichever is earlier except Arrears on salary which are usually announced from a back date and therefore cannot be taxed when due.
- Arrears on salary are taxable on receipt basis. However, one can claim relief under section 89, as arrears may put individual tax payer on Higher Tax Bracket.
- Individuals can get relief on account of arrears in salary to the extent of difference between Increase in the Tax Liability of Current year and Increase in Tax liability as if tax payer has received that income in the Assessment year for which it is pertains;
- It is Mandatory to file Form No. 10E online before filling of ITR to claim relief under section 89. In case, you haven't filed Form No. 10E and claimed Relief under section 89, the tax payer will be receiving an Income tax notice from the Income-tax department shortly. ■