
RULE 2A

House rent allowance*

The statutory background

2A.1 Section 10(13A) of the Act grants exemption in respect of any house rent allowance received by an employee from his employer subject to the satisfaction of certain basic conditions. Rule 2A prescribes the quantum of exemption admissible.

2A.1-1 *Constitutional validity* - Rule 2A does not in any way run counter to any provisions of Act—*CIT v. H.V. Yazdi* [1978] 114 ITR 14 (Cal.).

2A.1-2 *Taxability of HRA* - The question whether HRA is *ab initio* taxable as income under 'salaries' or not, now stands settled by the judgment of the Supreme Court in the case of *Karamchari Union v. Union of India* [2000] 243 ITR 143. The Supreme Court held that Dearness Allowance, City Compensatory Allowance and House Rent Allowance are taxable as 'profits in lieu of salary'.

Basic conditions to be satisfied

2A.2 The following basic conditions must be satisfied :

- ◆ The allowance must be specifically granted to the employee by his employer to meet expenditure actually incurred on payment of rent in respect of residential accommodation occupied by the assessee.
- ◆ The employee should not be the owner of the residential accommodation occupied by him.
- ◆ The employee must have actually incurred expenditure on payment of rent.

Para 5.3-9 of Circular No. 1/2019, dated 1-1-2019 provides that only the expenditure actually incurred on payment of rent in respect of residential accommodation occupied by the assessee subject to the limits laid down in rule 2A, qualifies for exemption from income-tax. Thus, house rent allowance granted to an employee who is residing in a house/flat owned by him is not exempt from income-tax.

In case of assessee living in wife's house

2A.3 In *Bajrang Prasad Ramdharani v. Asstt. CIT* [2013] 37 taxmann.com 186/60 SOT 66 (URO) (Ahd. - Trib.) assessee's claim for exemption under section 10(13A) was disallowed on ground that rent was paid by the assessee as tenant to his wife who was landlord and both were living together. The Tribunal held that since house was owned by wife of the assessee and the assessee had paid rent to her through bank transfer entry, the assessee had fulfilled twin requirements of section 10(13), *i.e.*, occupation of house and payment of rent, and, thus, would be entitled to exemption under section 10(13A).

*SECTION 10(13A).

Employer - Employee relationship is a must

2A.4 In *CIT v. UK Bose* [2013] 29 taxmann.com 219/212 Taxman 399 (Delhi) in return of income, the assessee disclosed salary received from 'S' and claimed deduction under section 10(13A) on basis of rent paid by him which had been debited from his salary directly. The Assessing Officer rejected assessee's claim taking a view that income received by the assessee was not taxable under head 'salary' but under head 'income from other sources'. It was held that since it was not case of the Assessing Officer that relationship between 'S' and the assessee was not that of a master and servant, impugned order passed by him was to be set aside and the assessee's claim for deduction was to be allowed.

Payee need not necessarily be the landlord

2A.5 There is no stipulation, either in section 10(13A) or in rule 2A, that the employee should pay the rent only to the landlord of the house occupied by the employee. Even in cases where payments are deposited in courts or with Rent Controller, the exemption can be availed by the employee.

Quantum of exemption

2A.6 For determining the quantum of exemption, the place where the accommodation is situated is divided into :

- (i) major cities, *i.e.*, Mumbai, Delhi, Calcutta and Chennai, and
- (ii) other places.

The amount exempt is the *least* of the following :

Major cities	Other places
◆ Allowance actually received	◆ Allowance actually received
◆ Rent paid in excess of 10 per cent of salary	◆ Rent paid in excess of 10 per cent of salary
◆ 50 per cent of salary	◆ 40 per cent of salary

It is important to note from the above formula that, where rent paid is less than or equal to 10 per cent of salary, the amount exempt will be *nil*.

2A.6-1 *Meaning of 'salary'* - In terms of *Explanation (ii)* to rule 2A, 'salary' shall include dearness allowance if the terms of employment so provide. Thus, 'salary' shall not include other allowances & perquisites.

The following points must also be noted :

- ◆ Where dearness pay is treated as 'pay' for purposes of pension, gratuity and compensatory allowances including house rent allowance, the term 'salary' will include such dearness pay also for purposes of calculating the exempt portion of HRA—*CBDT Circular No. 90, dated 26-6-1972* [**Annex 2A.1**].
- ◆ Where commission based on sales is paid in addition to fixed salary as part of the contract of employment, such commission will form part of salary - *Gestetner Duplicators (P.) Ltd. v. CIT* [1979] 117 ITR 1 (SC).
- ◆ Even if commission is paid with reference to profits, it would partake the character of salary if it is a mode of remuneration or recompense for the services rendered by the employee—*Raja Ram Kumar Bhargava v. CIT* [1963] 47 ITR 680 (All.).

- ◆ The Calcutta High Court had held in one case that commission paid in lieu of fixed salary is not to be treated as 'salary' for the purpose of rule 2A—*CIT v. H.V. Yazdi* [1978] 114 ITR 14. This decision cannot be considered as good law in the light of the subsequent decision of the Supreme Court in *Gestetner Duplicators case (supra)*.
- ◆ Contractual bonus will form part of 'salary'—*CBDT Circular No. 80, dated 4-3-1972*. It was however held in the case of *CIT v. B. Ghosal* [1980] 125 ITR 744 (Ker.) that, for the purpose of rule 2A, salary will not include bonus.

The Court observed as under :

"The question whether a particular payment made to an employee constitutes 'salary' for the purpose of rule 2A will have to be determined only by reference to the definition of that expression as contained in rule 2(h) of Part A of the Fourth Schedule to the Act. On a close study of the said rule in conjunction with rules 4 and 5 of the same Part in the same Schedule, it appears to us to be perfectly clear that bonus cannot be regarded as falling within the scope of the expression 'salary' as defined in clause (h) of rule 2. Clauses (b) and (c) of rule 4 contain a clear indication that the expression 'salary' takes in only periodical payments made by the employer to the employee during a year by way of remuneration. Clause (4)(b) of rule 5 empowers the Commissioner to relax the provisions of rule 4(c) and to permit the crediting by the employer to the individual accounts of the employees of the periodical bonuses or other contributions of a contingent nature. If bonus were to form part of the salary of the employee, the proportionate contribution has to be automatically credited by the employer and there is absolutely no necessity for this provision for relaxation of the rules." (p. 749)

It is, however, not clear whether the payment of bonus in that case was on facts a contractual payment or it was an *ex gratia* payment. Moreover, the Kerala High Court differed with the view of Madras High Court in *CIT v. India Radiators Ltd.* [1976] 105 ITR 680 where bonus was held to be a part of the salary after passing of the Payment of Bonus Act. The view of the Madras High Court appears to reflect the correct legal position. If the bonus is a contractual payment, as mostly it is these days, it would be includible in the salary. If it is not a contractual payment but is an *ex gratia* payment, it does not partake of the character of salary, as it would not be compensation for services rendered.

2A.6-2 *Period that should be reckoned* - In view of *Explanation (ii)* to rule 2A, basic pay, dearness allowance and commission are determined on 'due' basis in respect of the period during which rental accommodation is occupied by the employee in the previous year. Thus, emoluments of a period other than the relevant previous year are not to be considered, even though such amount is received (as well as taxed) during the previous year. Again, emoluments of the period during which rental accommodation is not occupied in the previous year are left out of computation.

ILLUSTRATIONS

1. An employee working in Bombay is in receipt of house rent allowance of Rs. 1,250 p.m. He is occupying a residential accommodation, for which rent paid by him is Rs. 2,000 p.m. He is getting a salary of Rs. 3,500 p.m. and dearness allowance of Rs. 1,000 p.m. which counts for retirement benefits.

The exemption will be worked out as follows :

(i) House rent allowance received for the year	Rs. 15,000 (A)
(ii) Rent paid less 10 per cent of salary including dearness allowance	24,000 minus $(54,000 \times 10/100) =$ Rs. 18,600 (B)
(iii) 50 per cent of salary	Rs. 27,000 (C)
Exemption admissible (least of A, B and C)	Rs. 15,000

2. An employee working in Cuttack, receives house rent allowance of Rs. 600 p.m. and is paying a rent of Rs. 700 p.m. in respect of residential accommodation occupied by him. He is getting salary of Rs. 2,000 p.m. and dearness allowance of Rs. 800 p.m. which is not counted for retirement benefit.

The exemption will be worked out as follows :

(i) House rent allowance received for the year	Rs. 7,200 (A)
(ii) Rent paid less 10 per cent of salary excluding dearness allowance	8,400 minus $(24,000 \times 10/100) =$ Rs. 6,000 (B)
(iii) 40 per cent of salary	Rs. 9,600 (C)
Exemption admissible (least of A, B and C)	Rs. 6,000

HRA paid to retired Judges

2A.7 A retired Judge, who has been appointed by State Government/Central Government to any post, cannot be brought under purview of section 22D of the High Court Judges (Conditions of Service) Act, 1954 so as to be entitled to claim exemption from income-tax in respect of house rent allowance received by him as an appointee to such post - *Justice Challa Kondaiah v. CIT* [2001] 119 Taxman 511 (AP).

HRA and housing perquisite

2A.8 In *Dy. CIT v. Kuldeep D. Kaura* [2012] 137 ITD 370/23 taxmann.com 225 (Ahd. - Trib.) the assessee was an employee of a company and was paid house rent allowance [HRA] for his leased accommodation. The employer had obtained a residential flat on leave and license basis *vide* an agreement with the landlord of flat and provided the same to the assessee for his residential accommodation. The employer recovered from the assessee's salary the lease rent of Rs. 1.70 lakhs on monthly basis and paid the same to the landlord. The assessee was getting HRA of Rs. 3 lakhs per month including special HRA of Rs. 1.70 lakhs per month. The assessee claimed exemption under section 10(13A) for the amount of reimbursement of rental expenses paid to the employer of Rs. 1.70 lakhs per month. The Assessing Officer held that since the assessee was not paying rent to the landlord directly, he was not entitled to the benefit of section 10(13A). He also held that since the assessee was allowed to occupy free accommodation provided by the employer for which the employer was paying rent as per the leased license agreement, the assessee was not eligible to exemption under section 10(13A). The Assessing Officer, therefore, disallowed the claim of exemption under section 10(13A). On appeal, the assessee contended that since he was not occupying any housing accommodation owned by him and he was paying rent of Rs. 1.70 lakhs per month although not to the landlord directly but by way of reimbursement to the employer, he was eligible for exemption under section 10(13A), because such reimbursement of rent to the employer would also amount to payment of rent by him. The Commissioner (Appeals) held that it was a case where rent was paid by the employer to the landlord and the same was recovered from the assessee. The

rental agreement between the landlord and the employer was for the purpose of safeguarding the interests of the landlord. The Assessing Officer's view that since employer was paying rent, even though the same was recovered from the assessee, the assessee was not entitled for exemption under section 10(13A) in respect of HRA, was ill founded. *Prima facie*, the assessee was eligible to claim exemption under section 10(13A) in respect of HRA. He, therefore, allowed the claim of the assessee for exemption under section 10(13A).

It was held that the Commissioner (Appeals) had proceeded to decide the issue on this basis alone that since the rental agreement between the landlord and the employer was for the purpose of interest of landlord and the rent was being reimbursed by the assessee to the employer, the assessee was eligible for exemption under section 10(13). But he had not considered the second objection of the Assessing Officer that the assessee was allowed to occupy the leased accommodation provided by the employer for which the employer paid rent as per lease and license agreement and this was also one of the reasons given by the Assessing Officer for disallowing the claim of the assessee under section 10(13A). In the instant case, the assessee was getting twin benefit from the employer, one of which was not taxed on the basis of reimbursement of rent by the assessee to the employer. The first benefit was of rent-free accommodation provided by the employer to the assessee for which the employer was incurring rental expenditure of Rs. 1.70 lakhs per month. The second benefit being received by the assessee was that he was getting HRA of Rs. 3 lakhs per month including special HRA of Rs. 1.70 lakhs per month. Against these two benefits being received by the assessee, the assessee was making one payment, *i.e.*, reimbursement of rentals to the employer at the rate of Rs. 1.70 lakhs per month. Now, if this reimbursement of rent to the employer of Rs.1.70 lakhs per month was considered against the free housing accommodation provided by the employer to the assessee, then this reimbursement of house rent to employer was no more available to be considered for exemption under section 10(13A). As per rule 3, the perquisite value of the housing accommodation provided by the employer has to be worked out at the rate of 15 per cent of the salary or actual amount of lease rental paid by the employer whichever is lower as reduced by the rent if any actually paid by the employee. In the instant case, 15 per cent of the salary will be more than the actual rent being paid by the assessee, *i.e.*, Rs. 1.70 lakhs per month, and the same amount had been reimbursed by the assessee to the employer and, therefore, perquisite value of housing accommodation provided by the employer to the assessee was 'nil' as per rule 3. But once, the housing perquisite value was worked out as 'nil' after considering this rental payment of Rs. 1.70 lakhs per month to the employer, there was no rental payment made by the assessee for the purpose of working out exemption of HRA under section 10(13A). Therefore, the disallowance made by the Assessing Officer regarding the claim of the assessee for exemption under section 10(13A) was in order.

Evidence for claim of house rent allowance

2A.9 Rule 26C provides that the assessee shall furnish name, address and PAN of the landlord(s) where the aggregate rent paid during the previous year exceeds Rs. 1,00,000. The particulars shall be furnished in Form No. 12BB.

For financial year 2018-19, *para 4.6-5 of Circular No. 1/2019, dated 1-1-2019* provides that :

“DDOs have been authorized u/s 192 to allow certain deductions, exemptions, or allowances or set-off of certain loss as per the provisions of the Act for the purpose of estimating the income of the assessee or computing the amount of tax deductible under the said section. The evidence/proof/particulars for some of the deductions/exemptions/allowances/set-off of loss claimed by the employee such as rent receipt for claiming deduction in HRA, evidence of interest payments for claiming loss from self-occupied house property, etc., is not available to the DDO. To bring certainty and uniformity in this matter, section 192(2D) provides that person responsible for paying (DDOs) shall obtain from the assessee evidence or proof or particular of claims such as House Rent Allowance (where aggregate annual rent exceeds one lakh rupees); Leave Travel Concession or Assistance; deduction of interest under the head ‘Income from house property’ and deduction under Chapter VI-A as per the prescribed Form No. 12BB laid down by rule 26C of the Rules.”

Para 5.3-9 of above circular provides that

“Section 192(2D) read with rule 26C makes it obligatory for DDO to obtain following details/evidences in respect of exemptions for house rent allowance :

- (i) Rent paid to the landlord
- (ii) Name of the landlord
- (iii) Address of the landlord
- (iv) PAN of the landlord

Where the aggregate rent paid during the financial year exceeds one lakh Rs. the employee is required to furnish these detail in Form 12BB.”

In *Mrs. Meena Vaswani v. Asstt. CIT* [2017]80 taxmann.com 2/164ITD 120 (Mum. - Trib.) the assessee received House Rent Allowance (HRA) from her employer which was claimed as exempt under section 10(13A). In response to show cause notice, the assessee submitted that she had a self occupied property jointly held with her husband but she had to live in her mother’s house and pay her rent for her day-to-day living cost. The Assessing Officer taking a view that the assessee failed to establish genuineness of payment of rent, rejected her claim.

The Tribunal held that the assessee could not produce any evidence arising in normal course of transaction of hiring of premises such as leave and license agreement, letter to society intimating about her tenancy, payment through bank, cash payments backed with known sources, electricity bill payments through cheque, water bill payments through cheque, etc. Moreover, the mother of assessee had also not filed return and the said rental income was not brought to tax in her hands. On facts, the whole arrangement of rent payment by the assessee to her mother was a sham transaction which was undertaken with sole intention to claim exemption of HRA under section 10(13A). Therefore, the Assessing Officer was justified in rejecting the assessee’s claim.

ANNEXURE TO RULE 2A

ANNEX 2A.1

CIRCULAR NO. 90 [F. NO. 275/79/72-ITJ], DATED 26-6-1972

'SALARY' INCLUDES DEARNESS PAY

1. I am directed to invite reference to this Ministry's letter F. No. 12/19/64-IT(A-I), dated 2-1-1967 [**Annex 2A.1**] wherein the manner in which the house rent allowance is to be treated as exempt from income-tax under section 10(13A) read with rule 2A of the Income-tax Rules, was explained.

2. As per rule 2A "salary" has the same meaning as assigned to it in clause (h) of rule 2 of Part A of the Fourth Schedule to the Act, *i.e.*, "salary" includes dearness allowance if the terms of employment so provide but excludes all other allowances and perquisites. A question has arisen about the treatment to be given to the element of "dearness pay" in relation to rule 2A insofar as Government servants are concerned. With the issue of orders in the Government of India, Ministry of Finance (Department of Expenditure), O.M. No. F.1(34) E-II(B)/68, dated 18-1-1969, "dearness pay" is considered as "pay" for purposes of pension and gratuity and compensatory allowance (including house rent allowance, etc.) in the case of Central Government servants. It is, therefore, clarified that *for the purposes of calculating the house rent allowance that would be exempt under rule 2A, the term "salary" includes "dearness pay"* also. Where State Government servants are being paid "dearness pay" as in the case of Central Government employee, the clarification given above will apply.

3. The above clarification may please be brought to the notice of all Disbursing Officers and State undertakings under the control of the State Government; this may be kept in view, *inter alia*, for calculating income-tax to be deducted at source from "salaries".