Income Tax

Easy to Understand

Prepared by:-

Arif Ahmad
Payroll & T.B. Division

An Introduction to Income Tax

WHAT IS A TAX?

- Tax is a fee charged by a government on a product, income or activity.

There are two types of taxes

Direct Tax **Indirect Tax**

- **If tax is levied directly on the income or wealth of a person, then it is a direct tax e.g. income-tax, wealth tax.**
- **If tax is levied on the price of a good or service, then it is called an indirect tax e.g. excise duty, custom duty, service tax and sales tax or value added tax. In the case of indirect taxes, the person paying the tax passes on the incidence to another person.**

WHY ARE TAXES LEVIED?

- The reason for levy of taxes is that they constitute the basic source of revenue to the government. Revenue so raised is utilised for meeting the expenses of government like defence, provision of education, health-care, infrastructure facilities like roads, dams etc.

LEVY OF INCOME-TAX- (On whom?)

- Income-tax is a tax levied on the total income of the previous year of every person. A person includes:-
  - An individual,
  - Hindu Undivided Family (HUF),
  - Association of Persons (AOP),
  - Body of Individuals (BOI),
  - A firm,
  - A company.
  - Any other Artificial Judicial Person.

TOTAL INCOME AND TAX PAYABLE

- Income-tax is levied on an assessee's total income. Such total income has to be computed as per the provisions contained in the Income-tax Act, 1961. Let us go step by step to understand the procedure of computation of total income for the purpose of levy of income-tax.

  - Step 1 Determination of residential status
  - Step 2 Classification of income under different heads
  - Step 3 Exclusion of income not chargeable to tax (Exemptions)
  - Step 4 Computation of income under each head
  - Step 5 Clubbing of income of spouse, minor child etc.
  - Step 6 Set-off or carry forward and set-off of losses
  - Step 7 Computation of Gross Total Income.
  - Step 8 Deductions from Gross Total Income
  - Step 9 Total income
  - Step 10 Application of the rates of tax on the total income(As per relevant Finance Act)
  - Step 11 Education cess and secondary and higher education cess
  - Step 12 Advance tax and tax deducted at source.

HEADS OF INCOME:

The Act prescribes five heads of income.

SALARIES	INCOME FROM HOUSE PROPERTY	PROFITS AND GAINS OF BUSINESS OR PROFESSION	CAPITAL GAINS	INCOME FROM OTHER SOURCES

- These heads of income exhaust all possible types of income that can accrue to or be received by the tax payer.
- Salary, pension earned is taxable under the head 'Salaries'.

- Rental income is taxable under the head 'Income from house property'.
- Income derived from carrying on any business or profession is taxable under the head 'Profits and gains from business or profession'.
- Profit from sale of a capital asset (like land) is taxable under the head 'Capital Gains'.
- The fifth head of income is the residuary head under which income taxable under the Act, but not falling under the first four heads, will be taxed.
- The tax payer has to classify the income earned under the relevant head of income.

  These heads of income exhaust all possible types of income that can accrue to or be received by the tax payer.

- Salary, pension earned is taxable under the head 'Salaries'.
- Rental income is taxable under the head 'Income from house property'.
- Income derived from carrying on any business or profession is taxable under the head 'Profits and gains from business or profession'.
- Profit from sale of a capital asset (like land) is taxable under the head 'Capital Gains'.
- The fifth head of income is the residuary head under which income taxable under the Act, but not falling under the first four heads, will be taxed.
- The tax payer has to classify the income earned under the relevant head of income.

Exclusion of income not chargeable to tax

- There are certain income which are wholly exempt from income-tax e.g. Agricultural income. These incomes have to be excluded and will not form part of Gross Total Income.
- Also, some incomes are partially exempt from income-tax e.g. House Rent Allowance, Education Allowance, Conveyance, Medical Allowances. These incomes are excluded only to the extent of the limits specified in the Act.
- The balance income over and above the prescribed exemption limits would enter computation of total income and have to be classified under the relevant head of income.

Computation of income under each head

- Income is to be computed in accordance with the provisions governing a particular head of income.
- There are deductions and allowances prescribed under each head of income. For example, while calculating income from Salary, Professional Tax (so deducted) allowed as deduction. Same when calculating income from house property, municipal taxes and interest on loan are allowed as deduction. Similarly, deductions and allowances are prescribed under other heads of income. These deductions etc. have to be considered before arriving at the net income chargeable under each head.

Set-off or carry forward and set-off of losses

- An assessee may have different sources of income under the same head of income. He might have profit from one source and loss from the other. For instance, an assessee may have profit from his textile business and loss from his printing business. This loss can be set-off against the profits of textile business to arrive at the net income chargeable under the head .Profits and gains of business or profession..
- Similarly, an assessee can have loss under one head of income, say, Income from house property and profits under another head of income, say, Profits and gains of business or profession. There are provisions in the Income-tax Act for allowing inter-head adjustment in certain cases.
- For Example Loss from House Property (Interest paid on House Building Loan) can be set off against Salary Income.

Computation of Gross Total Income.

- The final figures of income or loss under each head of income, after allowing the deductions, allowances and other adjustments, are then aggregated, after giving effect to the provisions for clubbing of income and set-off and carry forward of losses, to arrive at the gross total income.

Deductions from Gross Total Income (Under Chapter VI A)

Deduction in respect of certain Payment / Investment under the following sections.

- **80 C: - Maximum Limit of exemption limit is Rs 1, 00,000.**

  One can get the benefit of deduction under this section if he/ she:-

  1) Paid LIC premium

2) Investment in Fixed deposit (At least for 5 yrs)
3) Investment in pension Fund
4) Contribution to Recognized Provident Fund.
5) Contribution to Public Provident Fund.
6) Post office recurring deposit. (at least for 5 yrs)
7) Investment in National Saving certificate.
8) Principle Amount paid in respect of House building loan.
9) Tax Saving Mutual Fund.
10) Tuition Fess paid.

- 80 CCF: - Investment in Infrastructure Bonds. (Maximum limit is RS 20,000)
- 80 D: - Medical Insurance Premium Paid. (Maximum exemption limit is RS 15,000 & 20,000 in case of senior citizen. Additional 15,000 (20000 in case of senior citizen) can claim if mediclaim policy is taken for dependent parents.
- 80 DD: - Maintenance including medical treatment/insurance of disable dependent (Maximum limit is RS 50,000)
- 80 DDB: - Medical treatment in respect of dependent disable suffering from special disease (Maximum limit is RS 40,000)
- 80E:- Interest Paid on educational Loan.
- 80 G: - Donation to approved charitable institution/ National Fund (deduction will be 50% or 100% of the donation depending upon the cases)

Total income

- The income arrived at, after claiming the above deductions from the Gross Total Income is known as the Total Income.

Application of the rates of tax on the total income

- The rates of tax for the different classes of assesses are prescribed by the Annual Finance Act. The tax rates have to be applied on the total income to arrive at the income-tax liability.(Rate as per Finance Act 2010, relevant to Previous year 2010-11 following A.Y.2011-202, are as under).

Income Tax , A Quick Guide for Beginner

Threshold limit (Basic Exemption Limit):-

Income tax slabs 2010-2011 (for Individual Male) in India:	
Income Tax Slab (in Rs.)	Tax
0 to 1,60,000	No Tax
1,60,001 to 5,00,000	10%
5,00,001 to 8,00,000	20% + (34000)
Above 8,00,000	30% +(34000+60000)

Income tax slabs 2010-2011 (for Women) in India:	
Income Tax Slab (in Rs.)	Tax
0 to 1,90,000	No Tax
1,90,001 to 5,00,000	10%
5,00,001 to 8,00,000	20% + (31000)
Above 8,00,000	30% + (31000+60000)

Income tax slabs 2010-2011 (for Senior Citizens) in India:	
pIncome Tax Slab (in Rs.)	Tax
0 to 2,40,000	No Tax
2,40,001 to 5,00,000	10%
5,00,001 to 8,00,000	20% + (26000)
Above 8,00,000	30% + (26000+60000)

***An educational cess of 3% on tax payable.(Education Cess @ 2% & Secondary and higher secondary education cess @ 1%)**