Assessment of Individual Income Tax, Tax Planning and Saving in India

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Abstract  
Individual income tax is a subject matter of central govt. If an individual wants to assess his/her income tax then he/she should have knowledge of individual income tax structure. Individuals after calculating their total income for a particular financial year can assess their income tax after deduction of saving and doing other adjustments. By doing so they can plan in advance about their savings and income tax.

Key Words: Tax Structure after Independence, Tax Structure Post Liberalization, Computation of Total Income, Computation of Income Tax.

INTRODUCTION  
The tax system in India mainly is a three tier system which is based between the Central government, State Governments and the Local government organizations. India has a well-developed tax structure with clearly separated authority between Central and State Governments and local bodies. Central Government levies taxes on income, customs duties, central excise and service tax.  

According to the Constitution of India, the government has the right to levy taxes on organizations and individuals. However, the constitution states that no one has the right to levy taxes except the authority of law or the parliament. The main body, which is responsible for the collection of taxes, is the Central Board of Direct Taxes, which is a part of the Department of Revenue under the Ministry of Finance of the Indian government. The CBDT functions as per the Central Board of Revenue Act of 1963. In last 10-15 years, Indian taxation system has undergone wonderful reforms. The tax laws have been simplified and the tax rates have been rationalized resulting in better compliance, ease of tax payment and better enforcement.

OBJECTIVE OF THE STUDY  
- To study the for assessment of individual income tax  
- To study the planning of individual income tax  
- To study the saving of individual income tax

- To study how to get exemption from individual income tax

TAX STRUCTURE INDIA  
Indian Tax Structure after Independence:  
The period after Independence was quite challenging for the tax planners. An enormous black economy set in both due to Second World War and increases in economic activity after independence. Savings and investment were encouraged through the different taxation laws by the way of incentives. There was a requirement for generating huge amount of revenues to fund the economic growth of the country. The tax department took great care to plan the tax structure not only with the aspect to widen the income tax base but also to look for alternate taxes and to eliminate tax avoidance. The department was harshly tested due to the high volumes of work.

Some of the prominent taxes that came into existence were:
- Business profits tax (1947)
- Capital Gains (1946-48 to 1956)
- Estate Duty (1953)
- Wealth Tax (1957)
- Expenditure Tax (1957)
- Gift Tax (1958)

To Check the growth of black money, high denomination notes were demonetized in 1946. In 1961, The Income tax Act was remodified, replacing the outdated law of 1922.

Income tax Structure Post Liberalization:  
The wave of tax reforms that started across the world in the second half of 1980’s found its way into India. As part of its policy of liberalization, India introduced tax reforms in the 1990’s. The reforms introduced in the Indian tax structure are various in comparison to other countries. In India, The tax reforms took place independent of interference from any external multilateral agency unlike some other countries. But the tax reforms took place in such a way as to ensure its obedience to the prevailing international trends.

An Individual means a human being or a natural person. It includes both male and female. It also includes a minor child or lunatic but their assessment would be made on
their guardian or manager under section 161(1). In the case of deceased person, assessment would be made on the legal representative.

**Income to be considered while computing total income of individuals**

1) **Income earned by individual himself.** Income earned by an individual in his individual capacity i.e., Income from salaries, Income from house property, Profits and gains of business or profession, capital gains and income from other sources.

2) **Income earned as a partner of a firm or a limited liability partnership.**
   a) Salary, bonus etc. Received by a partner is taxable as his business income.
   b) Interest on capital and loans to the firm is taxable as business income of the partner.
   c) Share of profit in the firm is exempt in the hands of the partner.

Note: The income mentioned in (a) and (b) above is table to the extent they are allowed as deduction to the firm.

3) **Income earned as a member of HUF**
   a) Share of income of HUF is exempt in the hands of the member.
   b) Income from an impartibly estate of HUF is taxable in the hands of the holder of the estate who is the eldest member of the HUF.
   c) Income from self-acquired property converted into joint family property.

4) **Income earned as a member of AOP, etc.**
   a) Where the income of AOP or BOI is chargeable at maximum marginal rate: Share of income of a member from such AOP or BOI will not be included in his taxable income at all.
   b) Where the income of AOP or BOI is taxed at normal rates i.e., the rates applicable to an individual: Share of income of a member from such AOP or BOI will be included in the taxable income of the individual only for rate purposes and a relief under section 86 shall be allowed.
   c) Where no income tax is chargeable on the income of the AOP or BOI: Share of income of a member from such AOP/BOI will be chargeable to tax as part of his total income.

5) **Income of other persons included in the total income of the individual.**
   a) Transferee’s income, where there is a transfer of income without transfer of assets.
   b) Income arising to transferee from a revocable transfer of an asset.
   c) Income of spouse as mentioned in 64(1).
   d) Income from assets transferred to son’s wife of to any person for the benefit of son’s wife.
   e) Income of minor child as mentioned in section 64(1A).

Note: In case (a) and (b), income is includible in the hands of the transferor.

**Computation of Total Income**

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. The procedure of computation of total income for the purpose of levy of income tax is detailed hereunder -

1) **Determination of residential status of Individual.** The residential status of a person has to be determined to ascertain which income is to be included in computing the determines his residential status. Based on the time spent by him, he may be (a) resident in India. The residential status of an individual determines the taxability of income earned by him. For example, income earned outside India will not be taxable in the hands of an non-resident but will be taxable in case of a resident and ordinarily resident.

2) **Classification of income under various heads.**
   The Act prescribes five heads of income. These heads of income exhaust all possible types of income that can accrue to or be received by an individual. An individual has to classify the income earned by him under the relevant head of income.

3) **Exclusion of exempted income.** There are certain incomes which are wholly exempt from income tax e.g., income from mutual fund. These incomes have to be excluded and will not form part of GTI. Also, some incomes are partially exempt from income tax e.g., HRA, Education allowance etc. These incomes are excluded only to the extent of the limits specified in the Act. The balance income over and above the prescribed limits would enter computation of total income and have to be classified under the relevant head of income.
4 **Computation of net income under each head.**
Income is to be computed in accordance with the provisions governing a particular head of income. Under each head of income, there is a changing section which defines the scope of income chargeable under that head. There are deductions and allowances prescribed under each head of income. These deductions and allowances have been considered before arriving at the net income chargeable under each head.

5 **Clubbing of incomes.** In case of individuals income tax is levied on a slab system on the total income. The tax system is progressive i.e. as the income increases, the applicable rate of tax increases. Some taxpayers in the higher income bracket have a tendency to divert some portion of their income to their spouse, minor child etc. To minimize their tax burden. In order to prevent such tax avoidance, clubbing provisions have been incorporated in the Income tax Act, under which income arising to certain persons (like spouse, minor child etc.) has to be included in the income of the person who has diverted his income to such persons for the purpose of computing tax liability. Effect has to be given to these clubbing provisions.

6 **Set-off and carry forward of losses.** An individual may have different sources of income under the same head of income. He might have profit form one source and loss from the other. For instance, an individual may have profit from his let-out property and loss from his self-occupied property. This loss can be set-off against the profits of the let-out property to arrive at the net income chargeable under the head ‘Income from other sources’. 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. Further, losses which cannot be set-off in the subsequent years as per the provisions contained in the Income-tax Act.

7 **Computation of Gross Total Income.** The final figures of income or loss under each head of income, after allowing the deductions allowance 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.

8 **Deduction from Gross Total Income.** There are deductions prescribed from gross total income. The allowable deductions in cases of an individual are deductions under section 80C, 80CCC, 80CD, 80D, 80DD, 80DDB, 80E, 80G, 80GG, 80GGA, 80GMC, 80I, 80IAB, 80IB, 80IC, 80ID, 80IE, 80JA, 80QGB, 80RRB and 80U. These deductions are allowable subject to satisfaction of the conditions prescribed in the relevant section.

9 **Computation of Total Income.** The total income of an individual is arrived at, after claiming the above deductions from the gross total income.

**Computation of Income Tax**

Regardless of the changes made by legislators since 1913, the basic formula for computing the amount of tax owed has remained basically the same. To determine the amount of income tax owed, certain deductions are taken from an individual’s gross income to arrive at an adjusted gross income, from which additional deductions are taken to arrive at the taxable income. Once the amount of taxable income has been determined, tax rate charts determine the exact amount of tax owed. If the amount of tax owed is less than the amount already paid through tax prepayment or the withholding of taxes from paychecks, the taxpayer is entitled to a refund from the IRS. If the amount of tax owed is more than what has already been paid, the taxpayer must pay the difference to the IRS.

Calculating the gross income of restaurant employees whose income is partially derived from gratuities left by customers has led to disputes with the IRS and employers over how much they should contribute in federal insurance contribution act (fica) taxes. Although customers pay these tips directly to employees, federal law deems the tips to have been wages paid by the employer for FICA tax purposes. Employers are imputed to have paid large sums of money they never handled and for which they no way of ascertaining the exact amount. The Supreme Court, in *United States v. Fior D’Italia*, 536 U.S. 238, 122 S. Ct. 2117, 153 L. Ed. 2d 280 (2002), upheld the IRS
"aggregate method" of reporting tip income. Instead of requiring the IRS to make individual determinations of unreported tips for each employee when calculating FICA tax, the Court held that the IRS could make employers report their gross sales on a monthly statement to help determine tip income. Employees also must report their tip income monthly on a form. The IRS then uses these two pieces of information to calculate what the employer needs to contribute in FICA tax.

**Gross Income:** The first step in computing the amount of tax liability is the determination of gross income. Gross income is defined as "all income from whatever source derived," whether from personal services, business activities, or capital assets (property owned for personal or business purposes). Compensation for services in the form of money, wages, tips, salaries, bonuses, fees, and commissions constitutes income. Problems in defining income often arise when a taxpayer realizes a benefit or compensation that is not in the form of money.

An example of such compensation is the fringe benefits an employee receives from an employer. The Internal Revenue Code defines these benefits as income and places the burden on the employee to demonstrate why they should be excluded from gross income. Discounts on the employer's products and other items of minimal value to the employer are usually not considered income to the employee. These benefits (which include airline tickets at nominal cost for airline employees and merchandise discounts for department store employees) are usually of great value to the employee but do not cost much for the employer to provide, and build good relationships between the employee and the employer. As long as the value to the employer is small and the benefit generates goodwill, it usually is not deemed to be taxable to the employee.

The value of meals and lodging provided to an employee and paid for by an employer is not considered income to the employee if the meals and lodging are furnished on the business premises of the employer for the employee's convenience (as when an apartment building owner provides a rent-free apartment for a caretaker who is required to live on the premises). However, a cash allowance for meals or lodging that is given to an employee as part of a compensation package is considered compensation, and is counted as gross income. An employer's payment for a health club membership is also included in gross income, as are payments to an employee in the form of stock. An amount contributed by an employer to a pension, qualified stock bonus, profit-sharing, annuity, or bond purchase plan in which the employee participates is not considered income to the employee at the time the contribution is made, but will be taxed when the employee receives payment from the plan. Medical insurance premiums paid by an employer are generally not considered income to the employee. Although military pay is taxable income, veterans' benefits for education, disability and pension payments, and veterans' insurance proceeds and dividends are not included in gross income.

Other sources of income directly increase the wealth of the taxpayer and are taxable. These sources commonly include interest earned on bank accounts; dividends; rents; royalties from copyrights, trademarks, and patents; proceeds from life insurance if paid for a reason other than the death of the insured; annuities; discharge from the obligation to pay a debt owed (the amount discharged is considered income to the debtor); recovery of a previously deductible item, which gives rise to income only to the extent the previous deduction produced a tax benefit (this is commonly referred to as the tax benefit rule and is most often used when a taxpayer has recovered a previously deducted bad debt or previously deducted taxes); gambling winnings; lottery winnings; found property; and income from illegal sources. Income from prizes and awards is taxable unless the prize or award is made primarily in recognition of religious, charitable, scientific, educational, artistic, literary, or civic achievement; the recipient was chosen, without any action on his or her part, to enter the selection process; and the recipient is not required to render substantial future services as a condition to receiving the prize or award. For example, recipients of Nobel Prizes meet these criteria and are not taxed on the prize money they receive.

In some situations a taxpayer's wealth directly increases through income that is not included in the determination of income tax. For example, gifts and inheritances are excluded from income in order to encourage the transfer of assets within families. However, any income realized from a gift or inheritance is considered income to the beneficiary—most notably rents, interest, and dividends. In addition, most scholarships, fellowships, student loans, and other forms of financial aid for education are not included in gross income, perhaps to equalize the status of students whose education is funded by a gift or inheritance and of students who do not have the benefit of such assistance. Cash rebates to consumers from product manufacturers and most state unemployment compensation benefits are also not included in gross income.

Capital gains and losses pose special considerations in the determination of income tax liability. Capital gains are the profits realized as a result of the sale or exchange of a capital asset. Capital losses are the deficits realized in such transactions. Capital gains and losses are determined by
establishing a taxpayer's basis in the property. Basis is generally defined as the taxpayer's cost of acquiring the property. In the case of property received as a gift, the donee basically steps into the shoes of the donor and is deemed to have the same basis in the property as did the donor.

The basis is subtracted from the amount realized by the sale or other disposition of the property, and the difference is either a gain or a loss to the taxpayer.

Capital gains are usually included in gross income, with certain narrow exclusions, and capital losses are generally excluded from gross income. An important exception to this favorable treatment of capital losses occurs when the loss arises from the sale or other disposition of property held by the taxpayer for personal use, such as a personal residence or jewelry. When a capital gain is realized from the disposition of property held for personal use, it is included as income even though a capital loss involving the same property cannot be excluded from income. This apparent discrepancy is further magnified by the fact that capital losses on business or investment property can be excluded from income. Consequently, there have been many lawsuits over the issue of whether a personal residence, used at some point as rental property or for some other income producing use, is deemed personal or business property for income tax purposes.

Taxpayers age 55 or older who sell a personal residence in which they have resided for a specific amount of time can exclude their capital gains. This is a one-time exclusion, with specific dollar limits. Consequently, if future, greater gains are anticipated, a taxpayer age 55 or older may choose to pay the capital gains tax on a transaction that qualifies for the exclusion but produces smaller capital gains.

Even though a capital gain on a personal residence is realized, it may be temporarily deferred from inclusion in gross income if the taxpayer buys and occupies another home two years before or after the sale, and the new home costs the same as or more than the old home. The gain is merely postponed. This type of transaction is called a rollover. The gain that is not taxed in the year of sale will be deducted from the cost of the new home, thereby establishing a basis in the property that is less than the price paid for the home. When the new home is later sold, the amount of gain recognized at that time will include the gain that was not recognized when the home was purchased by the taxpayer.

**Deductions and Adjusted Gross Income:** Once the amount of gross income is determined, the taxpayer may take deductions from the income in order to determine adjusted gross income. Two categories of deductions are allowed. Above-the-line deductions are taken in full from gross income to arrive at adjusted gross income. Below-the-line, or itemized, deductions are taken from adjusted gross income and are allowed only to the extent that their combined amount exceeds a certain threshold amount. If the total amount of itemized deductions does not meet the threshold amount, those deductions are not allowed. Generally, above-the-line deductions are business expenditures, and below-the-line deductions are personal, or non-business, expenditures.

The favorable tax treatment afforded business and investment property is also evident in the treatment of business and investment expenses. Ordinary and necessary expenses are those incurred in connection with a trade or business. Ordinary and necessary business expenses are those that others engaged in the same type of business incur in similar circumstances. With regard to deductions for expenses incurred for investment property, courts follow the same type of "ordinary-and-necessary" analysis used for business expense deductions, and disallow the deductions if they are personal in nature or are capital expenses. Allowable business expenses include insurance, rent, supplies, travel, transportation, salary payments to employees, certain losses, and most state and local taxes.

Personal or non business expenses are generally not deductible. Exceptions to this rule include casualty and theft losses that are not covered by insurance. Certain expenses are allowed as itemized deductions. These below-the-line deductions include expenses for medical treatment, interest on home mortgages, state income taxes, and charitable contributions. Expenses incurred for tax advice are deductible from federal income tax, as are a wide array of state and local taxes. In addition, an employee who incurs business expenses may deduct those expenses to the extent they are not reimbursed by the employer. Typical unreimbursed expenses that are deductible by employees include union dues and payments for mandatory uniforms. Alimony payments may be taken as a deduction by the payer and are deemed to be income to the recipient; however, child support payments are not deemed income to the parent who has custody of the child and are not deductible by the paying parent.

Contributions made by employees to an individual retirement account (IRA) or by self-employed persons to keogh plans are deductible from gross income. Allowable annual deductions for contributions to an IRA are lower than allowable contributions to a Keogh account. Contributions beyond the allowable deduction are permitted; however, amounts in excess are included in
gross income. Both IRAs and Keogh plans create tax-sheltered retirement funds that are not taxed as gross income during the taxpayer's working years. The contributions and the interest earned on them become taxable when they are distributed to the taxpayer. Distribution may take place when the taxpayer is 59 and one-half years old, or earlier if the taxpayer becomes disabled, at which time the taxpayer will most likely be in a lower tax bracket. Distribution may take place before either of these occurrences, but if so, the funds are taxable immediately and the taxpayer may also incur a substantial penalty for early withdrawal of the money.

Additional Deductions and Taxable Income: Once adjusted gross income is determined, a taxpayer must determine whether to use the standard deduction or to itemize deductions. In most cases the standard deduction is used because it is the most convenient option. However, if the amount of itemized deductions is substantially more than the standard deduction and exceeds the threshold amount, a taxpayer will receive a greater tax benefit by itemizing.

After the standard deduction or itemized deductions are subtracted from adjusted gross income, the income amount is further reduced by personal and dependency exemptions. Each taxpayer is allowed one personal exemption. A taxpayer may also claim a dependency exemption for each person who meets five specific criteria: the dependent must have a familial relationship with the taxpayer; have a gross income that is less than the amount of the deduction, unless she or he is under nineteen years old or a full-time student; receive more than one-half of her or his support from the taxpayer; be a citizen or resident of the United States, Mexico, or Canada; and, if married, be unable to file a joint return with her or his spouse. Each exemption is valued at a certain dollar amount, by which the taxpayer's taxable income is reduced.

Tax Tables and Tax Owed: Once the final deductions and exemptions are taken, the resulting figure is the taxpayer's taxable income. The tax owed on this income is determined by looking at applicable tax tables. This figure may be reduced by tax prepayments or by an applicable tax credit. Credits are available for contributions made to candidates for public office; child and dependent care; earned income; taxes paid in another country; and residential energy. For each dollar of available credit, a taxpayer's liability is reduced by one dollar.

Refund or Tax Owed: Finally, after tax prepayments and credits are subtracted, the amount of tax owed the IRS or the amount of refund owed the taxpayer is determined. The taxpayer's tax return and payment of tax owed must be mailed to the IRS by April 15 unless an extension is sought. Taxpayers who make late payments without seeking an extension will be charged interest on the amount due and may be charged a penalty. A tax refund may be requested for up to several years after the tax return is filed. A refund is owed usually because the taxpayer had more tax than necessary withheld from his or her paychecks.

Tax Audits: The IRS may audit a taxpayer to verify that the taxpayer correctly reported income, exemptions, or deductions on the return. The majority of returns that are audited are chosen by computer, which selects those that have the highest probability of error. Returns may also be randomly selected for audit or may be chosen because of previous investigations of a taxpayer for tax evasion or for involvement in an activity that is under investigation by the IRS. Taxpayers may represent themselves at an audit, or may have an attorney, certified public accountant, or the person who prepared the return accompanies them. The taxpayer will be told what items to bring to the audit in order to answer the questions raised. If additional tax is found to be owed and the taxpayer disagrees, she or he may request an immediate meeting with a supervisor. If the supervisor supports the audit findings, the taxpayer may appeal the decision to a higher level within the IRS or may take the case directly to court.

Conclusion: Any individual who want to assess his/her income tax and want to do tax planning and savings, first he/she has to calculate his/her total income then compute the income tax by deduction and adjustment in total income as per tax table structure. If tax is paid in access then get refund from the income tax department. Finally do the tax audit.

References:

About Author: Dr. Rajiv Kaushik is presently working as Professor in department of management, Vaish College of Engineering, Rohtak. He is having 16 years of experience both in industry and academia. He has conducted MDPs in HIPA & SISI. His area of interest is marketing, retailing and strategic management.