



International tax policy

Tashkent State University of Economics

Lecture 5



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
- 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
- Step 11 Surcharge
- Step 12 Education cess and secondary and higher education cess
- Step 13 Advance tax and tax deducted at source

Step 1 . Determination of residential status



The residential status of a person has to be determined to ascertain which income is to be included in computing the total income. The residential statuses as per the Income-tax Act are shown below .

Residential status under Income Tax Act !961		
Resident		Non-resident
Resident And ordinary resident	Resident but not-ordinary resident	

- In the case of an individual, the duration for which he is present in India determines his residential status. Based on the time spent by him, he may be (a) resident and ordinarily resident, (b) resident but not ordinarily resident, or (c) non-resident.
- The residential status of a person determines the taxability of the income. For e.g., income earned outside India will not be taxable in the hands of a non-resident but will be taxable in case of a resident and ordinarily resident.

Step 2 . Classification of income under different heads

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.

Step 3 - Exclusion of income not chargeable to tax

- ① There are certain income which are wholly exempt from income-tax e.g. Agricultural income. These income have to be excluded and will not form part of Gross Total Income.
- ① Also, some incomes are partially exempt from income-tax e.g. House Rent Allowance, Education Allowance. These incomes are excluded only to the extent of the limits specified in the Act.
- ① 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.

Step 4 - Computation of 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 charging section which defines the scope of income chargeable under that head.
- There are deductions and allowances prescribed under each head of income. For example, while 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.

Step 5 . Clubbing of income of spouse, minor child etc.

- ◎ **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 Act, under which income arising to certain persons (like spouse, minor child etc.) have to be included in the income of the person who has diverted his income for the purpose of computing tax liability.**

Step 6 . Set-off or carry forward and set-off of losses

- ① **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..**
- ② **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.**
- ③ **Further, losses which cannot be set-off in the current year due to inadequacy of eligible profits can be carried forward for set-off in the subsequent years as per the provisions contained in the Act.**

Step 7 . Computation of Gross Total Income.

- ① 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.

Step 8 . Deductions from Gross Total Income



There are deductions prescribed from Gross Total Income. These deductions are of three types

Deduction in respect of certain payments	Deduction in respect of certain incomes	Other deductions
<ol style="list-style-type: none">1. Life insurance premium paid2. Contribution to provident fund/ Pension fund3. Medical insurance premium paid4. Payment of interest of loan taken for higher education5. Rent paid6. Certain donations7. Contribution to political parties	<ol style="list-style-type: none">1. Profit and gains from undertaking engaged in infrastructural development2. Profit and gains from undertaking engaged in development of SEZ3. Certain income of co-operative societies4. Royalty income etc of authors5. Royalty on patents	<p>Deduction in case of person with disability</p>

Step 9 . Total income



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

Step 10 . 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.

Step 11 . Surcharge



Surcharge is an additional tax payable over and above the income-tax. Surcharge is levied as a percentage of income-tax.

Step 12 . Education cess and secondary and higher education Cess on income-tax

- ◎ The income-tax, as increased by the surcharge, is to be further increased by an additional surcharge called education cess @2%. The Education cess on income-tax is for the purpose of providing universalised quality basic education. This is payable by all assesses who are liable to pay income-tax irrespective of their level of total income.**

- ◎ Further, .secondary and higher education cess on income-tax. @1% of income-tax plus surcharge, if applicable, is leviable from A.Y.2008-09 to fulfill the commitment of the Government to provide and finance secondary and higher education.**

Step 13 - Advance tax and tax deducted at source

- ① Although the tax liability of an assessee is determined only at the end of the year, tax is required to be paid in advance in certain instalments on the basis of estimated income.
- ① In certain cases, tax is required to be deducted at source from the income by the payer at the rates prescribed in the Act. Such deduction should be made either at the time of accrual or at the time of payment, as prescribed by the Act.
- ① For example, in the case of salary income, the obligation of the employer to deduct tax at source arises only at the time of payment of salary to the employees. Such tax deducted at source has to be remitted to the credit of the Central Government through any branch of the RBI, SBI or any authorized bank. If any tax is still due on the basis of return of income, after adjusting advance tax and tax deducted at source, the assessee has to pay such tax (called self-assessment tax) at the time of filing of the return.

RETURN OF INCOME

- ① **The Income-tax Act, contains provisions for filing of return of income.**
- ① **Return of income is the format in which the assessee furnishes information as to his total income and tax payable. The format for filing of returns by different assessees is notified by the CBDT.**
- ① **The particulars of income earned under different heads, gross total income, deductions from gross total income, total income and tax payable by the assessee are required to be furnished in a return of income.**
- ① **In short, a return of income is the declaration of income by the assessee in the prescribed format.**
- ① **The Act has prescribed due dates for filing return of income in case of different assessees. All companies and firms have to mandatorily file their return of income before the due date.**
- ① **Other persons have to file a return of income if their total income exceeds the basic exemption limit.**