What is income tax? How is it calculated?

Income tax is an annual tax charged on income of a person by the government. It is charged for the corresponding assessment year at the rates laid down by the Finance Act for the assessment year in respect of the previous year.

**Income of the person is categorized under the following five heads**

Salaries
Income from house property
Profits and gains of business or profession
Capital gains
Income from other sources.

Income is calculated under these heads separately and accordingly tax is calculated using the income tax slab issued by the government every financial year.

Define Assessment Year.

Assessment year is the period that starts from 1 April and ends on 31 march. It is the year immediately succeeding the financial year wherein the income of the previous financial year is assessed. Government use assessment year for calculating tax on the previous year.

**For example :** If the current assessment year is 2015-16, which starts from I April 2015 and ends on 31 March 2016. To this assessment year financial year is 2014-15, starting from I April 2014 and ends on 31 March 2015. You will be calculating income tax for financial year in the assessment year.

Define Previous Year.

Previous Year is the year in which the income earned becomes taxable in the following assessment year. It can be stated as the Financial year preceding the Assessment year. For example- If the present assessment year is 2015-16 then the previous year will be 2014-2015.

Define financial year?

A twelve month period starting from 1 April and ending at 31 March which is used for calculating various annual financial statements in businesses and organization is known as financial year.

Differentiate between Financial Year, Assessment Year and Previous Year?

Assessment year and previous year are the types of financial year which consists of twelve months starting from 1 April to 31 March. Previous financial year is the preceding year of assessment financial year.

Define the term person?

A "person" means an individual, an ordinary partnership, a non-juristic body of person and an undivided estate. The term "person" under the Income Tax Act includes an individual, a Hindu Undivided Family, a Company, a Firm, an Association of Persons, a Local Authority and Artificial Juridical persons.

Who is an assessee?

An "Assessee" is a person who is liable to pay tax or any other sum of money under the Act.

**It includes**

1. Every person in respect of whom any proceeding under this Act has been taken for the assessment of his income or of the income of any other person in respect of whom he is assessable, or of the loss sustained by him or by such other person, or of the amount of refund due to him or to such other person;
2. Every person who is deemed to be an assessee under any provision of this Act;
3. Every person who is deemed to be an assessee in default under any provision of this Act.

What do you understand by total income?

Total Income is the amount on which the Income Tax is paid. Total income include all income that accrue, arise, earned or received in India (except those income which accrues or arises outside India). Total Income is the total amount earned by an individual or organization, including income from employment or providing services, revenue from sales, payments from pension plans, income from dividends, or other sources. Total income is generally calculated for the assessment of taxes, evaluating the net worth of a company, or determining an individual or organization's ability to make payments on a debt.

How many heads are there under total income? Name them.

**There are five heads under total income. They are**

- Income from Salaries
- Income from house property
- Profits and gains of business or profession
- Capital gains
- Income from other sources

At what rate firms are required to pay tax on their income?

Income Tax is paid at 30% of taxable income. Surcharge is charged at 10% of the Income Tax, where taxable income is more than Rs. 1 crore. (Marginal Relief in Surcharge, if applicable) and Education Cess is 3% of the total of Income Tax and Surcharge.

How will you decide the residential status of an individual?

As per the provisions of Income Tax Act residential status of an individual is categorized as Resident and Non Resident.
Under Section 6(1), an individual is said to be resident in India in any previous year if he satisfies any one of the following basic conditions:

1. He is in India in the previous year for a period of at least 182 days.
2. He is in India for a period of at least 60 days during the relevant previous year and at least 365 days during the four years preceding that previous year.

The above provisions are applicable only to those who are residents of India irrespective of their nationality otherwise they are included in Non resident.

Does the tax liability of an individual get affected due to his residential status? If yes, explain.

Yes, tax liability of an individual does gets affected due to his residential status as per Section % of the Income Tax Act 1961 and is also dependent on place and time of accrual or receipt of income. You must understand the difference between Indian income and Foreign income as Indian income is always taxable in India in accordance with the residential status of the taxpayer.

**Indian income is categorized as**

1. Income received or deemed to be received in India during previous year and simultaneously accrual income or deemed accrual in India during previous year.
2. Income received or deemed to be received in India during the previous year but it accrues outside India during the previous year, or Income received outside India during the previous year but accrues in India during the previous year.

What are the basic and additional conditions for Resident and ordinarily resident (ROR)?

The basic conditions for being resident and ordinarily resident is the same condition that satisfies the residential status of an individual and additional conditions for Resident and ordinarily resident in India in a given previous year are mentioned below:

1. If you are resident in India in at least 9 out of 10 previous years as per the basic conditions that satisfies the residential status of an individual preceding the relevant

previous year.
2. If you are in India for a period of at least 730 days during 7 years preceding the relevant previous year.
3. An individual or HUF becomes ROR in India if the individual fulfills at least one of the basic conditions that satisfies the residential status of an individual both the additional conditions.

Who are resident but not ordinary resident?

A resident but not ordinary resident is the one who is not the resident in India for 9 out of the 10 preceding previous years or he has during the 7 preceding years been in India for a period of, or period amounting to 729 days or less.

Who are non resident?

An individual who does not fulfill the below mentioned conditions in that previous year will be considered as Non Resident:

1. You have to be in India atleast 182 days in that year, OR
2. You have to atleast be in India for 365 days during 4 years preceding that year and atleast 60 days in that year.

Which income is considered as accrued income?

Income which has been earned but not yet received is known as accrued income. Income is recorded in the same accounting period in which it is earned rather than in the subsequent period in which it will be received.

What is FBT?

1. FBT stands for **Fringe Benefit Tax** which is a tax that an employer has to pay in respect of the benefits that are given to his/her employees.
2. Fringe benefits is something that an employer provides to his employees in addition to the cash salary. FBT is payable in lieu of the value of fringe benefits provided or

deemed to have been provided by an employer to his employees during the previous year.

What is tax audit?

A tax audit is assessment of an organization's or individual's tax return by Internal Revenue Service (IRS) in order to find out that the income and deductions are recorded accurately.

What is Tax refund?

The excess tax paid by an individual than the actual owed is returned by the government which is known as tax refund. After taking into consideration income tax, withholdings, tax deductions or credits and other factors; you file income tax for the year, after that you will receive a tax refund.

What is capital gain? Explain long term capital gains and how is it different from short term capital gains?

1. Capital gains' means the profit earned from the sale of an asset. When the Capital Asset is being sold or transferred, the profit or gains arising out of it or you can term that as the difference between the actual price at which the asset was acquired and the price at which it is sold or transferred.
2. A long-term capital gain is the profit that arises with the sale of an asset that has been on hold for a definite period. This period ranges from one year to three years across different asset classes.
3. It is different from short term capital gains because short term capitals are kept for short period only that is less than a years.

What is deferred tax?

A tax liability that a company has to pay but does not pay at that current point and it will be responsible for paying it in future is termed a deferred tax. Deferred tax occurs due to the difference in a company's balance sheet, due to the differences between accounting practices and tax regulations.

What is working capital?

Working capital is the difference between a company's current assets and its current liabilities. Working Capital is used into day to day operations of any business.
WC= CA-CL

What is Taxation?

Taxation is one of the mode used by the government to finance their expenditure by imposing charges on citizens and corporate entities. Government levy tax on citizens to encourage or discourage certain economic decisions.

What is alternative minimum tax (AMT)?

The Alternative Minimum Tax (AMT) is a way to restrict wealthy taxpayers from tax evasion. AMT uses a separate set of rules to calculate taxable income after allowed deductions. This is generally for higher income group as AMT sets a limit on certain benefits that reduces a taxpayer's regular tax amount. As a result, if the benefits on tax reduce total tax below AMT limit, taxpayer has to pay the higher AMT amount.

How can a taxpayer get a refund for an overpayment of taxes?

There is a provision in India to get a refund for an overpayment of taxes along with interest. When you have to claim a refund you need to file the income tax return within a specified period. You can even track your refund status from the NSDL-TIN website by clicking in Status of Tax refunds and can track your refund by entering PAN and Assessment year for which the refund is to be claimed.

What are the Streamlined Sales and Use Tax Agreement?

The Streamlined Sales and Use Tax Agreement was introduced in 1999 by the National Governor's Association (NGA) and the National Conference of State Legislatures (NCSL) in order to simplify the collection of sales tax as sales tax is second largest source of state revenue after personal income taxes. It resulted in decveloping a simpler and business friendly sales tax system.

The Agreement decreases costs and administrative burdens of sales tax collection on retailers, especially those operating in multiple states.

Explain deferred tax asset?

When a firm has overpaid on taxes then the amount is recorded in the balance sheet as deferred asset tax which is also known as provision for future taxation. Deferred tax asset arises when the firm, pays taxes early or have paid excess of tax and is entitled to get some money back from the tax authorities.

Define deferred tax Liability? What items come under deferred tax liability?

A tax liability that a company owes and does not pay at that current point, although it will be responsible for paying it at some point in the future. Deferred tax liability (DTL) is a balance sheet item that accounts for the temporary difference between taxes that will come due in the future and taxes paid today.

The unrealized tax that is put into account comes under deferred tax liability. Depreciation is the main source or the type of an item of deferred tax liability.

Define Amortization & Impairment?

When the assets of the company are written off over a number of years for the purpose of their replacement or renewal and not depending on the life of asset is termed as amortization. It is different from depreciation, which is periodic writing off of the asset based on its normal life expectancy.

Impairment can be termed as the fall in the value of the asset due to any physical damage to the asset, obsolescence, or due to technological innovation. Impairments can be written off. Simply you can say that impairment is the difference between the fair value and the carrying value of an asset.

What is Inter Company Reconciliation?

Every year commonly controlled company prepares a combined or consolidated financial statement for tax and reporting purposes. Inter Company Reconciliation (ICR) is the process that helps parent company to split from its subsidiaries companies by location. Each year, commonly controlled business must prepare a combined or consolidated financial statement for tax and reporting purposes. The inter company accounting process is an important process for parent companies with subsidiaries or companies split by location. ICR helps in avoiding double counting of transactions as it also helps in maintaining accurate reports. Even it helps the companies to avoid misrepresentation of a firm's financial position.

What is the Securities Transaction Tax?

1. Securities Transaction Tax (STT) was introduced in India at time of 2004 budget and is applicable from 1 October 2004. STT is the tax which is payable on the amount of taxable securities transaction.
2. STT is just levied on purchase and sale of those securities that are listed on the Indian Stock Exchanges.
3. Securities Transaction Tax was introduced by the Finance Minister, P. Chidambaram to restrict people from evading tax on capital gains.

What is Permanent Account Number (PAN)?

Permanent Account Number (PAN) is a ten-digit alphanumeric number, which is issued by the Income Tax Department in the form of laminated card as PAN enables the department to link all kinds of transactions of the person with the department. Transactions include tax payments, TDS/TCS credits, returns of income/wealth/gift/FBT, specified transactions, correspondence, etc. PAN helps the department in maintaining a fair record of every persons transactions through a ten digit number in order to avoid tax evasion in any case.

What is the difference between profit and gain?

Profit is the amount that is left after deducting expenses from revenue that makes the receipt of revenue possible. There are two streams of earnings that is direct earnings and indirect earnings. Direct earnings are incurred from main activities and indirect earnings are incurred from other activities so the profits is calculated as gross profit and net profit.

Gross profit is the amount of revenue from which trading expenses has been deducted (expenses related to main activities of the business). Net profit is the amount of revenue that includes incomes from other activities.

Gain is the amount that is earned on selling assets which is not included in the inventory of the business. This sales activity is not the actual trading and these sales does not includes goods that are sold on regular basis.

What items fall under the category of ‘securities’?

'Securities' are defined under Section 2(h) of the Securities Contracts (Regulation) Act, 1956 (SCRA) to include:

1. Shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate derivatives.
2. Units or any other instrument issued by any collective investment scheme to the investors in such schemes.
3. Security receipt as defined in Section 2(zg) of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.
4. Such other instruments as declared by the central government and Rights or interest in securities.
5. Equity-oriented mutual funds (not debt-oriented mutual funds).

When Deferred Tax Asset & Deferred tax liability arises?

**Deferred tax asset** arises when the expenses are recorded in the income statement before they are required to be recognized by the taxing authority. Also when revenue is being taxed before it is taxable in the income statement.

**Deferred tax liability** arises from different depreciation methods being used for tax as depreciable assets are reported as non current.

What is the difference between Fund flow vs. Cash Flow?

**Fund Flow**

1. Fund flow is based on working capital.
2. Fund flows tells about the various sources from where the funds are generated.
3. Fund flow is useful for understanding long term financial strategy.
4. Changes in current assets and current liabilities are shown through the schedule of changes in working capital.

**Cash Flow**

1. Cash flow is based on only one element of working capital that is cash.
2. Cash flow starts with the opening balance of cash and closes with the closing balance of cash.
3. Cash flow is useful for understanding short term strategies that affects liquidity of the business.
4. Changes in current assets and current liabilities are shown in the cash flow.

If a NRI buys property in India, does he has to pay property tax?

Any income or capital gain that the NRI generates from the sale/ rent or lease of a valued property or an asset based in India will be taxed as per the Income Tax rules. f the property is more than 3 years old, long term capital gains tax will be incurred on the sale of the property. On long term capital gains, tax is payable at 20%.

Can a person fill a NRI in an Income tax form if he has been out of India for six months though he is Indian citizen?

He can fill NRI in an Income tax form only if he does not satisfy any of these two conditions:

1. He is in India in the previous year for a period of 182 days or more or
2. He is in India for a period of 60 days or more during the previous year and 365 days or more during the four years immediately preceding the previous year.

What is the difference between the excise duty and the sales tax?

Excise Duty is an indirect tax imposed on goods that are manufactured and produced within the country. This is paid by the manufacturer on the finished good when it goes out of the factory. Excise Duty is levied on all goods, except certain goods that are exempted. There are three types of Central Excise duties collected in India namely: Basic Excise Duty, Additional Duty of Excise, Special Excise Duty.

Sales Tax is imposed on the finished product which is paid by the consumer. Sales tax is imposed on sale or purchase within the State. Different states levy different levels of sales tax, while there is a Central Sales Tax levied on sale or purchase in the course of interstate trade.

What do you mean by fair rent?

Fair rent is the rent charged for a private property that is fixed and registered by a rent officer. Fair rent is decided on the basis of size, condition, and usefulness of the property. Fair rent is calculated in place of mortgage interest, other financing costs and depreciation related to certain property, including land, buildings and non movable equipment. It is calculated only once; at the time the facility begins operation.

Explain the procedure to calculate Provident Fund, ESI, VAT and Sales Tax.

**Provident Fund:** Provident fund is calculated at 12% on the basic salary which is deducted from employee's salary plus 12% on the basic is contributed by the employer. So, the aggregate 12% + 12 % is remitted to the Provident Fund Department.
**ESI:** Stands for Employee State Insurance and is calculated at 1.75% on the gross salary of the employees whose salary is below Rs. 10000 per month and employer contributes 4.75% on the gross salary of the employee and aggregate 1.75% + 4.75% is remitted to the ESI Department
**VAT:** VAT percentage is 1, 4, 12.5%. It is a tax which is charged on the basic value of the product by the seller from the buyer and the same is remitted to the Sales Tax Department.
**Sales tax:** Same as VAT

What is Excise & Service Tax? What is the difference?

**Excise tax** is an indirect tax that is imposed on the manufacture, sale or use on certain types of goods and products. Excise taxes are generally imposed on goods such as cigarettes or alcohol, also in the price of an activity such as gambling. Excise taxes may be imposed by both Federal and state authorities.

**Service tax** is an indirect tax imposed by the government on service providers on certain service transactions, but is actually paid by the customers. Services provided by air-conditioned restaurants and short term accommodation provided by hotels, inns, etc are included in the taxable services.

The major difference between excise tax and service tax is that excise tax is charged on manufactured goods and sales tax is imposed on certain services provided.

What is luxury tax?

A tax imposed on goods and services that are non-essential or not included in the necessities. Luxury tax is included in the indirect tax and is incurred by those who purchase or use the product. Ad valorem tax or progressive tax are some luxury tax that is imposed on high priced goods such as cars above a certain value or engine size, villas etc.

What do you mean by Commercial Tax?

Commercial Tax is a tax imposed on the scheduled Commercial goods as indirectly collected by the seller or purchaser against his business transaction which now comprises of Sales Tax, Entertainment, Luxury Tax, Entry Tax and Profession Tax.

What are the deductions under Salary Head? Name the items.

Deductions that are made under salary head are Entertainment allowance and Professional tax.

**Entertainment Allowance-** Entertainment allowance received is already included in the income of the employee and then a deduction is made only for government employees. A sum equal to 1/5th of salary (excluding all allowances, benefits and other perquisites) or Rs. 5,000, whichever is less is being deducted.

**Professional Tax-** Professional Tax is imposed by the government on employment by whatever name called, under Article 80C 276 of the Constitution and shall be allowed as a deduction. [Sec. 16(iii)]

What is Entertainment Tax?

Entertainment tax is imposed on every financial transaction that is related to entertainment such as movie tickets, major commercial shows and big private festivals, amusement parks, video games, exhibitions, celebrity stage shows, sports activities etc.

As per the Indian Constitution, entertainment is included in List 2. Revenue collected from entertainment tax is reserved primarily for the state governments.

What is form c & d in sales tax?

**Form C**

The sales tax on inter-state sale is 4% or the applicable sales tax rate for sale within the State whichever is lower if the sale is to a dealer registered under CST and the goods are covered in the registration certificate of the purchasing dealer. The purchasing dealer is eligible to get these goods at concessional rate if a declaration in C form is submitted to the selling dealer.

**Form D**

Sale to government is taxable 4% or applicable sales tax rate for sale within the State whichever is lower. This concession on CST is applicable if Form D is issued by the government department which purchases the goods.

What is excise duty?

Central Excise duty is an indirect tax levied on those goods which are manufactured in India and are meant for home consumption. The taxable event is 'manufacture' and the liability of central excise duty arises as soon as the goods are manufactured. It is a tax on manufacturing, which is paid by a manufacturer, who passes its incidence on to the customers.

What do you understand by transfer income?

Transfer of Income means when someone retains the ownership of an asset but makes an agreement to transfer its income, but still the income is considered as your income and it will be added to the total income.

What are the types of Provident funds?

**Below listed are the 4 types of provident funds**

**Recognized Provident Fund (RPF)-** RPF schemes must be approved by The Commissioner of Income Tax and pplicable to an organization which employs 20 or more employees.

**Unrecognized Provident Fund (URPF)-** URPF are not approved by The Commissioner of Income Tax and is started by employer and employees in an establishment.

**Statutory Provident Fund (SPF)-** This Fund is mainly meant for Government/University/Educational Institutes (affiliated to university) employees.

**Public Provident Fund (PPF)-** PPF involves minimum contribution of Rs.500 per annum and the maximum contribution is Rs. 100,000 per annum. The contribution made along with interest earned is repayable after 15 years, unless extended.

How will you calculate House Rent Allowance (HRA)?

**Minimum of following three amounts is available as HRA exemption:**

1. Actual House Rent Allowance provided by employer to employee.
2. House Rent paid in excess of 10% of Salary.
3. 50% of Salary in case House is located in Metro cities (Mumbai, Delhi, Kolkata, Chennai) or 40% in case of any other cities.

For all three conditions mentioned above relevant period is very important. Means if there is any change in Salary, HRA paid to employee, location of rented house and actual rent paid by employee HRA need to calculate from that relevant change Hence one should avoid calculating HRA on annual basis if there is any change in above factors.

Meaning of Salary for calculating HRA (Basic Salary + Dearness allowance if terms of employment so provide + fixed percentage of turnover achieved by employee)

What are allowable and dis-allowable expenditure?

**Allowable expenditure**

1. the cost of goods bought for the business
2. the prime costs of running a business asset
3. wages and salaries of employees
4. heat, light and cleaning of business premises
5. repairs to and maintenance of business premises
6. postage and stationery
7. business telephone and rental
8. bank charges and interest on business loans and overdrafts
9. travel and entertaining if the sole purpose is to retain or acquire business
10. legal costs of defending business rights and renewing leases of less than 50 years duration
11. bad debts and specific doubtful debts
12. protective clothes necessary for the business

**Dis allowable expenditure**

1. private expenditure
2. clothes bought for ordinary everyday wear
3. acquisition and depreciation of business assets
4. your own wages or salary
5. your business partner's wages or salary
6. payments to charities
7. travel expenses between your home and place of business
8. a general (non-specific) provision against doubtful debts
9. legal costs of acquiring land and buildings
10. fines for breaking the law
11. your own life, accident or sickness assurance
12. costs of alterations, additions or improvements to business premises

What do you understand by dissolution of firm?

Dissolution of firm means assets of firm are realized and liabilities are paid off and the surplus, if any is distributed among the partners according to their right. It is to be noted that 'dissolution of Firm' involves dissolution of partnership but dissolution of partnership may not lead to dissolution of firm.

Post your comment

Discussion Board

**Residential status**

in question of residential status. 1st Condition for Resident and Ordinarily resident is given as if person is resident for 9 years in 10 preceding previous year which should be 2 years in 10 preceding years.

*SHASHANK JHAJHARIA 02-16-2017*

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*Shikha Pandey 02-5-2015*

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*Shikha Pandey 02-5-2015*

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*Shikha Pandey 02-5-2015*

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Sale to government is taxable 4% or applicable sales tax rate for sale within the State whichever is lower. This concession on CST is applicable if Form D is issued by the government department which purchases the goods.