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How to check your tax liability

Knowing it helps avoid excess tax payment, over-investing in a tax-saving instrument and endless wait for refund

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In the last three months of a financial year, all we think about is tax saving. We make most of our investment in those three months, for the sole purpose of saving taxes. Therefore, it is no surprise that most of us go overboard with our tax-saving endeavours. And, then, we end up not only carrying this burden for many more years to come but adding to it each tax season. This is the case with all types of taxpayers.

If you are wondering how to avoid this, here's the solution. Know your tax liability for the year and you will not get into this trap of wrong investments.

"Many pay advance tax by September each year (say 2012) and any excess tax payment is refunded only by March or April, two years later (by 2014), making the refund process painful," says Pranay Bhatia, associate partner at Economic Law Practices. "If delayed, interest payment on the refund starts only after April (of 2014). Therefore, knowing the tax liability and paying accordingly helps. Second, investment instruments qualifying for tax exemptions aren't high-yielding ones and if one over invests in one, s/he loses tax benefits on another, thus lowering the net benefit in the other instrument."

While many might have heard of tax liability, they might not know how to calculate it. Here's some help:

Calculate total income

We take the example of a salaried individual (35-year-old male). He also earns by way of interest income (from savings bank account or fixed deposit or any other debt instruments) like most of us do. First, he should add all his incomes, that is, salary, interest income and annual payout(s), if any, like bonus and leave travel allowance (LTA). This would give his total income on which he will be taxed.

Deductions from income

Not all his income is taxable. That part can be reduced from the total income before calculating tax liability. Of course, he will need to spend/invest to avail of some of the deductions/exemptions. For instance, show rent receipts to claim deductions under the house rent allowance (HRA) head or show medical bills for reimbursements or making housing/education loan repayment.

The popular deductions are available under Section 80C, under which some specified instruments can be invested in for deductions from the taxable income like employee provident fund (EPF), public provident fund (PPF), life insurance and so on.

You can also claim deductions under certain other sections such as section 80D (payments towards health insurance for self and dependent parents), section 80DDB (medical treatment of a dependent who is a person with disability), section 80G (donations) and so on.

The remaining income after these deductions are made is the one on which you have to calculate and pay income tax.

Calculate taxable income

Income tax is applied in a "progressive way". That is, a higher income tax rate is applicable only to the income falling in that slab, and not on the entire income.

For instance, the salaried individual mentioned above earns a basic salary (monthly) is ₹25,000. He gets a dearness allowance (DA) of ₹10,000, special allowance of ₹5,000, HRA of ₹7,500 and a transport allowance of ₹500 per month. He also gets an annual bonus of ₹25,000.

He stays in a rented house and pays ₹8,000 a month as rent. He has contributed ₹3,000 every month towards EPF and pays ₹5,000 every year as premium towards life insurance. He also donates ₹5,000 to a charity.

ILLUSTRATION: AJAY MOHANTY

Therefore, his total income would be ₹5.76 lakh a year [(25,000+10,000+5,000+7,500+500) X 12].

Now, deduct the exempted incomes from the total income. The monthly transport allowance (₹500) is exempt from tax. The HRA would also be exempt from income tax. Thus, the taxable income comes to ₹5,76,000 – ((₹500+₹8,000) x 12), which is ₹4,74,000.

The donation made is also deductible by 50 per cent. Thus, the taxable income would stand at ₹4,74,000 – (50 per cent of ₹5,000) = ₹4,71,500. After considering Section 80C deductions, that is, contributions towards EPF and life insurance premium, the taxable income would stand at ₹4,71,500 – [(₹3,000 X 12) + ₹5,000] = ₹4,30,500. This is the final taxable income.

Calculate income tax liability

At present, income up to ₹2 lakh is exempt from tax for both men and women alike. The salaried individual we are discussing here will fall in the 10 per cent bracket (₹2 lakh and ₹5 lakh). The tax payable on his income stands at ₹30,000 [10 per cent of (₹5,00,000 – ₹2,00,000)]. An education cess of three per cent will be payable on this amount. Thus, the total tax payable will be ₹30,000 + three per cent of ₹30,000 = ₹30,900.

If you find this process tedious, you can use the tax-liability calculators available on many tax-related websites. But these can be equally tedious as you need to feed in a lot of data, and sometimes these calculators can be misleading also as they may not have provision to take in to account all kinds of tax benefits, according to experts.

TDS and advance tax

A salaried individual always pays a part of his tax liability by way of TDS (tax deducted at source), deducted by his employer from his salary or by his bank on the interest income on the fixed deposit.

Apart from this, he could be paying advance tax every quarter by self-assessing his tax liability. Thus, the tax payable by him at the end of the year would be equal to the amount left after deducting TDS and advance tax from the tax amount calculated above.