**What are tax and its types?**

A tax is a mandatory fee or financial charge levied by any government on an individual or an organization to collect revenue for public works providing the best facilities and infrastructure. The collected fund is then used to fund different public expenditure programs. If one fails to pay the taxes or refuse to contribute towards it will invite serious implications under the pre-defined law.

**Tax in India**

To run a nation judiciously, the government needs to collect tax from the eligible citizens; paying taxes to the local government is an integral part of everyone’s life, no matter where we live in the world. Now, taxes can be collected in any form such as state taxes, central government taxes, direct taxes, indirect taxes, and much more. For your ease, let’s divided the types of taxation in India into two categories, viz. direct taxes and indirect taxes. This segregation is based on how the tax is being paid to the government.

**Types of Taxes**

Be it an individual or any business/organization, all have to pay the respective taxes in various forms. These taxes are further subcategorized into direct and indirect taxes depending on the manner in which they are paid to the taxation authorities. Let us delve deeper into both types of tax in detail:

**Direct Tax**

* The definition of direct tax is hidden in its name which implies that this tax is paid directly to the government by the taxpayer
* The general examples of this type of tax in India are [Income Tax](https://groww.in/p/income-tax/) and Wealth Tax.
* From the government’s perspective, estimating tax earnings from direct taxes is relatively easy as it bears a direct correlation to the income or wealth of the registered taxpayers.

**Indirect Tax**

* Indirect taxes are slightly different from direct taxes and the collection method is also a bit different. These taxes are consumption-based that are applied to goods or services when they are bought and sold.
* The indirect tax payment is received by the government from the seller of goods/services.
* The seller, in turn, passes the tax on to the end-user i.e. buyer of the good/service.
* Thus the name indirect tax as the end-user of the good/service does not pay the tax directly to the government.
* Some general examples of indirect tax include sales tax, Goods and Services Tax ([GST](https://groww.in/p/gst/)), Value Added Tax (VAT), etc.

**Recent Reforms in Taxes**

In the year 2017, the government introduced Goods and Services Tax (GST) which is considered as the most revolutionary tax reform in independent India to date. Earlier also, governments levied various state and central taxes for availing various services or buying different goods. The problem with the earlier reforms was the taxation process was complex and the contradicting rules enabled some people to evade taxes through loopholes in the system. After the introduction of GST, a higher percentage of assesses was brought under the taxation umbrella and it took a toll on evaders as escaping from paying taxes became tougher.

**What is Income Tax?**

The most common type of tax that eligible citizens have to pay to the government. A part of your income is paid to the government every year and the government uses this money to fund support the growth and development activities across the country.

**Income Tax Assesse**

Any individual who is liable to file taxes and fall in the payable income tax slab is an income tax assesse. An individual who is having a regular income is exempted from paying tax if his/her include annual income is below the threshold level determined by the government from time to time or income from exempted sources such as agriculture.

**Income Tax Slabs**

As mentioned earlier, not all individuals shall pay the same amount of tax; the general rule is – the higher your income, the higher amount of tax you will have to pay. In order to ensure that tax rates and rules are fair rather than uniform, the government uses [income tax slabs](https://groww.in/p/income-tax-slab/) to determine the rate at which each individual tax assesse is liable to pay income tax.

**Income Tax Deductions**

Citizens having taxable income in excess of Rs. ₹ 2.5 lakhs are liable to pay income tax as per their applicable slab. However, there are a few tax savings options such as [ELSS](https://groww.in/p/equity-funds/elss-mutual-funds/), [Mutual Funds](https://groww.in/mutual-funds), [PPF](https://groww.in/p/savings-schemes/public-provident-fund-ppf/), [EPF](https://groww.in/p/savings-schemes/employees-provident-fund-epf/), [tax saver fixed deposits](https://groww.in/p/fixed-deposit/tax-saving-fixed-deposits/), and others that can be used to reduce the income tax payable by the individual. A majority of these tax saving schemes are available under [sections 80C](https://groww.in/p/section-80c/) and 80D of the Income Tax Act, 1961.

**Tax Deducted at Source**

[TDS](https://groww.in/p/tds/), short for Tax Deducted at Source is considered as one of the most common ways of deducting tax by the government from any salaried individual. Other cases of TDS can be seen in the case of interest provided on fixed deposits. However, in this case, also, the tax assesse can get a refund after filing the Income Tax Return (ITR).

**Tax Evasion Laws and Implications**

Various acts related to taxation have been framed by the Government of India and every citizen is liable to comply with these rules, failing which strict actions may be taken against them. Some of the sections of the taxation laws and penalties imposed for non-compliance are:

**Section 140A (1)**: If an assesse fails to pay the taxes, be it partially or wholly on principle amount of interest, he will be considered as a defaulter. The assessing officer can levy a fine equal to the arrear as per section 221 (1)

**Section 271 (C)**: In case an assesse doesn’t reveal the actual income or earning, a fine of 100% to 300% can be imposed on the defaulter in this section.

**Section 142 (1) and 143 (2)**: Under these sections, an income tax notice is sent to the defaulter and if he/she does not respond to it, the assessing officer can ask the assesse to file the return or furnish all details of assets and liabilities in writing.

Paying taxes is an integral part of all the citizens’ life and it helps in the upliftment of every section of the country by providing proper services and provisions. There are many other types of taxes such as GST, value-added tax (VAT), property tax, service tax, sales tax, entertainment tax and so on, that also constitutes government funding.

## Income Tax Slabs under new tax regime (Rates of Taxes)

From the FY 2020-21, a new tax regime is available for individuals and HUFs with lower tax rates and zero deductions/exemptions. Individuals and HUF have the option to choose the new regime or continue with the old regime.The new tax regime is optional and the choice should be made at the time of filing the ITR. If the old regime is continued than all the deductions/exemptions as available can be availed by the taxpayer. The income tax slabs under the new tax regime are:

|  |  |  |  |
| --- | --- | --- | --- |
| **New regime slab rates** | | **Existing regime slab rates** | |
| Income from Rs 2.5 lakh to Rs 5 lakh | 5% | Income from Rs 2.5 lakh to Rs 5 lakh | 5% |
| Income from Rs 5 lakh to Rs 7.5 lakh | 10% | Income from Rs 5 lakh to Rs 10 lakh | 20% |
| Income from Rs 7.5 lakh to Rs 10 lakh | 15% | Income above Rs 10 lakh | 30% |
| Income from Rs 10 lakh to Rs 12.5 lakh | 20% |  |  |
| Income from Rs 12.5 lakh to Rs 15 lakh | 25% |  |  |
| Income above Rs 15 lakh | 30% |  |  |

Most of the deductions like deductions and exemptions are not allowed if the taxpayers opts for the New Tax regime. However, he exemptions and deductions available under the new regime are:

* Transport allowances in case of a specially-abled person.
* Conveyance allowance received to meet the conveyance expenditure incurred as part of the employment.
* Any compensation received to meet the cost of travel on tour or transfer.
* Daily allowance received to meet the ordinary regular charges or expenditure you incur on account of absence from his regular place of duty.

## Exceptions to the Tax Slab

One must bear in mind that not all income can be taxed on slab basis. Capital gains income is an exception to this rule. Capital gains are taxed depending on the asset you own and how long you’ve had it. The holding period would determine if an asset is long term or short term. The holding period to determine nature of asset also differs for different assets. A quick glance of holding periods, nature of asset and the rate of tax for each of them is given below.

|  |  |  |
| --- | --- | --- |
| **Type of capital asset** | **Holding period** | **Tax rate** |
| [House Property](https://cleartax.in/s/house-property/) | Holding more than 24 months – Long Term Holding less than 24 months – Short Term | 20% Depends on slab rate |
| Debt mutual funds | Holding more than 36 months – Long Term Holding less than 36 months – Short Term | 20% Depends on slab rate |
| Equity mutual funds | Holding more than 12 months – Long Term Holding less than 12 months – Short Term | Exempt (until 31 March 2018) Gains > Rs 1 lakh taxable @ 10% 15% |
| Shares (STT paid) | Holding more than 12 months – Long Term Holding less than 12 months – Short Term | Exempt (until 31 March 2018)Gains > Rs 1 lakh taxable @ 10% 15% |
| Shares (STT unpaid) | Holding more than 12 months – Long Term Holding less than 12 months – Short Term | 20% As per Slab Rates |
| FMPs | Holding more than 36 months – Long Term Holding less than 36 months – Short Term | 20% Depends on slab rate |

## Residents and non residents:

Levy of income tax in India is dependent on the residential status of a taxpayer. Individuals who qualify as a resident in India must pay tax on their global income in India i.e. income earned in India and abroad. Whereas, those who qualify as Non-residents need to pay taxes only on their Indian income. The residential status has to be determined separately for every financial year for which income and taxes are computed.

# The five income heads under Income Tax Act



**1**/5

## ​Income from salary

Income from salary includes wages, pension, annuity, gratuity, fees, commission, profits, leave encashment, annual accretion and transferred balance in recognised Provident Fund (PF) and contribution to employees pension account.

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**2**/5

## ​Rental incomes

Rental Income from properties owned by a person other than those which are occupied by him are charged as income from house property. If property is vacant then a notional income is included under this head.

ThinkStock Photos



**3**/5

## ​Income from business/profession

Income from business or profession includes profit/loss from a business entity or a profession, any interest, salary or bonus to a partner of a firm.

Getty Images



**4**/5

## ​Capital gains

Income from capital gains includes long term capital gains (LTCG) and short term capital gains (STCG) on sale of any capital assets.

Getty Images



**5**/5

## ​Income from other sources

Income from other sources includes interest on bank deposits and securities, dividend, royalty income, winning on lotteries and races and gifts received among others.

|  |
| --- |
| Definition of Word 'Salary' or Income by way of Salary [Section 17(1)] |
| According to Section 17(1) salary includes the following amounts received by an employee from his employer, during the previous year :   1. Wages; 2. any annuity or pension; (Family pension received by heirs of an employee is taxable under income from other sources); 3. any gratuity; 4. any fees, commission, perquisites or profits in lieu of or in addition to any salary or wages; 5. any advance of salary; 6. any payment received by an employee in respect of any period of leave not availed of by him; (Leave encashment or salary in lieu of leave); 7. the annual accretion to the balance at the credit of an employee participating in a recognised provident fund, to the extent to which it is chargeable to tax under Rule 6 of part A of the Fourth Schedule; and 8. the aggregate of all sums that are comprised in the transferred balance as referred to in sub-rule (2) of Rule 1] of Part A of the Fourth Schedule, of an employee participating in a recognised provident fund, to the extent to which it is chargeable to tax, under sub-rule (4) there, i.e., taxable portion of transferred balance from unrecognised provident fund to recognised provident fund. 9. the contribution made by the Central Government or any other employer in the previous year, to the account of an employee under a pension scheme referred to in Section 8OCCD.   **The above definition of word ‘salary’ U/s 17(1) includes the above mentioned items. These can be explained in following manner :**   1. **Wages**—any amount received by a person for work done or job rendered is called wages. It may be received under the name of ‘Pay’, ‘Basic Pay’, ‘Salary’, ‘Basic salary’ or ‘Remuneration’. It may be for actual work or leave salary or actually received or due during the relevant previous year. Salary in lieu of Notice. It is fully taxable uls 15 if received during the relevent previous year. 2. **Any Annuity or Pension**—Any amount received by employee from past employer after attaining the age of retirement or superannuation is fully taxable. It may be received direct as pension or out of a superannuation fund created by employer; in both cases it is taxable. 3. **Any Gratuity**—Any sum received by employee from his past employer as a token of gratitude for services rendered in past is called gratuity. This amount is exempted upto certain limits given u/s 10(10) and it is dealt with in this very chapter at a later stage. 4. 1. **any Fee**—any amount received from employer under the name of fee is also fully taxable.    2. **any Commission**—any commissions given by employer to employee is fully taxable. Any commission received by a director for standing guarantee for repayment of loan, and if he is not employee of the company, shall be taxable under “Income from other sources”. In case commission is given to an employee and it is paid as a fixed percentage of turnover achieved by such employee, such commission shall also be treated as part of the salary for all practical purposes. [Gestener Duplicators (P) Ltd. vs. C.I. T. (1979) SC).    3. **any Bonus**—Bonus is fully taxable under the head ‘Salaries’ on receipt basis. In case arrears of bonus are received in a previous year, these are fully taxable. Bonus can be of two types :   **Statutory Bonus**—It is received under some legal or contractual obligation and is fully taxable. Gratuitous Bonus—It is a casual benefit and is taxable as a receipt from employer and having no other implication.   * 1. **any Perquisite**—Any benefit or amenity allowed by employer to employee. These are explained in detail later in this chapter u/s 17(2).   2. **any Profit in lieu of or in addition to salary**—any cash payment received by employee from employer is called profit in lieu of salary and these are explained later in this chapter u/s 17(3).  1. any salary in lieu of leave received during service is fully taxable. 2. **any advance salary**—In case an assessee receives some salary in advance in a previous year and which was actually not due in that year shall be taxable in the year of receipt. It does not include any loan or advance taken from employer. |