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Investments at Your Fingertips

# Here's how you can save taxes effectively

When Raushni was a child, she read a book on Paris. Ever since, she has been dreaming of walking the European streets, of eating croissants and gazing at the Eiffel Tower on a Parisan evening. Last year, when she finally got a job with a salary raise, she began saving for her trip, which she planned for September 2023.

One day, she was out for lunch with a friend and told him about her plan. He listened carefully and then asked her a question that completely threw her off-guard – "That's great, but now that you're in the taxable bracket, have you planned your taxes?"

Raushni realized that she hadn't! She quickly set up a call with her family's chartered accountant. The CA informed Raushni that her taxes were not deducted at source by her company since it's just a start-up. He asked her if she had any tax-saving investments, but she didn't. She hadn't planned her taxes at all! He looked over her financials and told her the possible amount that would be due in a couple of weeks. It was a significant portion of the amount that she had set aside for her trip. If she wanted to make tax-saving investments, she would have to invest her savings for the trip.

Had she planned her taxes in advance, Raushni could have saved a good chunk of the amount due in taxes and planned her finances better.

This is why tax planning is extremely important. It can help you invest wisely towards different goals and save money on taxes.

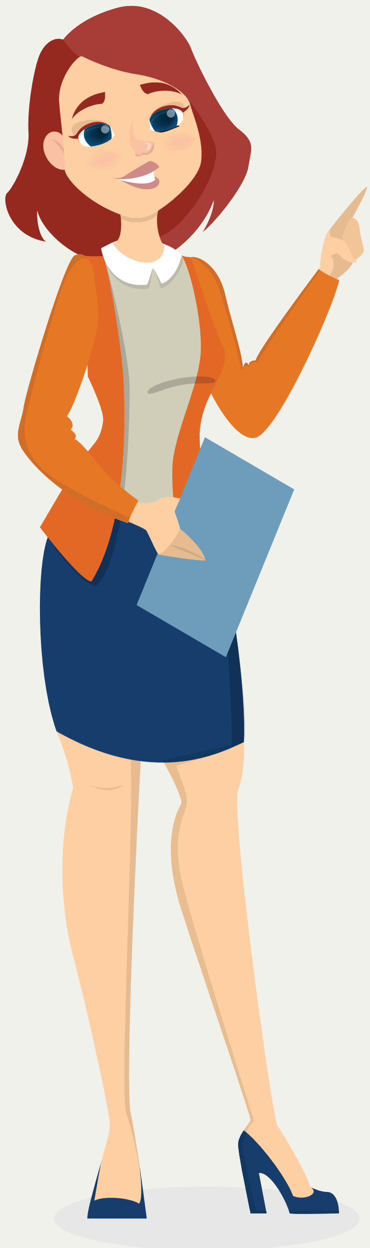
# What is Tax Planning?

Tax planning is the process of financially planning your taxes well in advance to reduce your tax liability. It is an effective way to manage your taxes through tax exemptions, rebates, deductions and benefits.

In simple terms, tax planning is a way to save your hard-earned money legally by investing in tax-saving instruments, making purchases that are tax deductible, claiming exemptions, etc. that are allowed under different sections of the Income Tax Act, 1961. When you plan your taxes at the beginning of the financial year, you will have enough time to make investments instead of deferring it to the last minute.

Tax planning varies from one individual to another depending on age, financial goals, income and risk appetite.

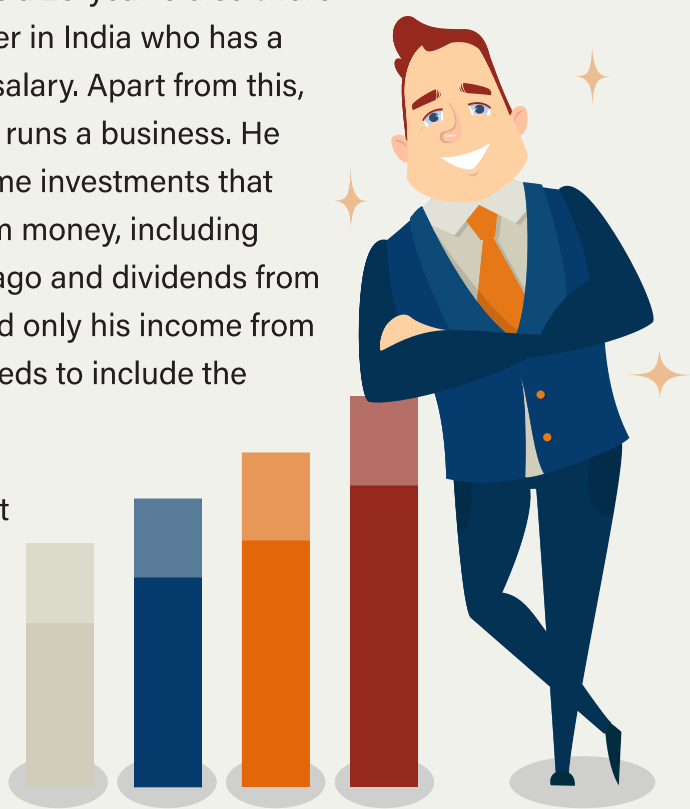
**When you plan your taxes, your aim is to reduce your tax liability. You can do this in a number of ways:**



1. Invest in tax-saving instruments
2. Claim expenses that are tax deductible. For instance, if you buy medical insurance for yourself, your spouse, your children or your dependent parents, you can claim the premiums paid as a tax deduction. This will reduce your total taxable income.
3. Claim house rent allowance deductions
4. Claim business expenses as deductions if you are filing business or professional taxes

The process of tax planning involves computing all sources of income that you have, determining your taxation bracket and then deciding how to invest to claim exemptions and deductions.

# Types of Taxable Income in India

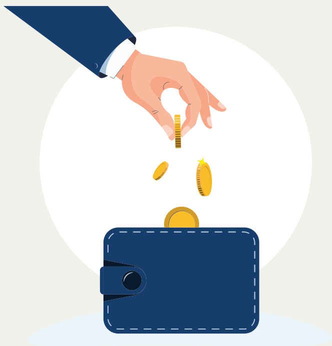


Rahul is a 28-year-old software engineer in India who has a stable salary. Apart from this, he also runs a business. He has some investments that make him money, including rent from a studio apartment he bought two years ago and dividends from stock investments. While filing for taxes, he reported only his income from salary. However, his accountant told him that he needs to include the other sources of income too.

When you file taxes in India, it isn't enough to report just your primary source of income. You need to report all your sources of income. If you plan your taxes based only on your primary source of income, you will be in for a rude shock when your taxes become due. This is why you need to know the different income sources you need to report.

**The income sources in India are divided into five distinct heads:**

## 1. INCOME FROM SALARIES

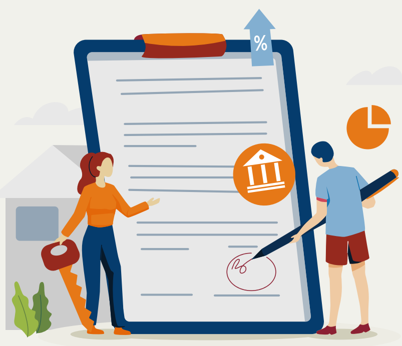


Any income that an individual makes through regular employment in an organization is categorized under this head. If you draw a salary, you will have to report your annual income here. Any pension that one receives after retirement is also reported under this head. As a salaried individual, you will have to submit Form 16, outlining details about your salary income.

## 2. INCOME FROM CAPITAL GAINS

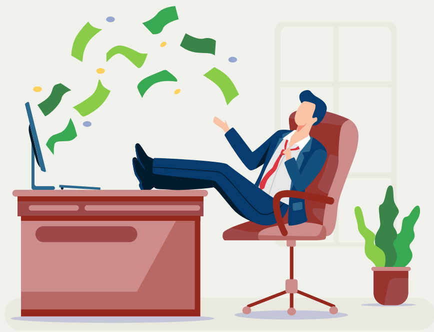
Apart from salaries, you may have made an income in a year by selling capital assets. For instance, if you sell property, debentures, shares, land, jewellery, etc., you need to report it under the head Income Earned from Capital Gains. Any profit earned on sale of capital assets is taxable.

## 3. INCOME FROM HOUSE PROPERTY



If you own residential property and you rent it out, you need to report this income. Rental income earned is taxable under the Income Tax Act, 1961. For instance, Rahul's income from his rental studio will need to be reported under this head. However, property used for business or professional services do not have to be reported.

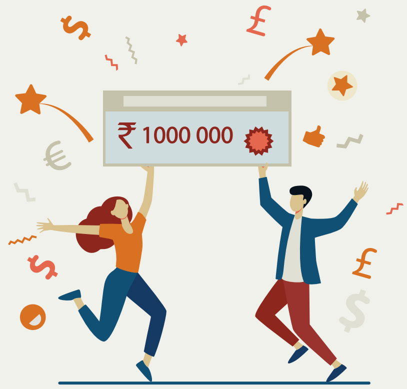
## 4. INCOME FROM BUSINESS/PROFESSION

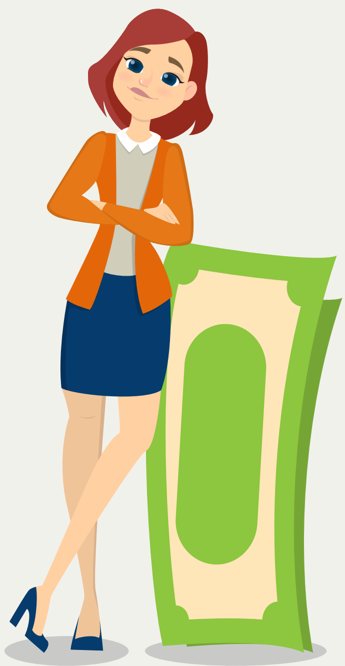


If you are a self-employed individual, earning income from business or profession, the income needs to be reported under this head. In case you have a business income in addition to your salary, you need to report both. This includes income from any freelance or consultancy activities. For example, if you are a chartered accountant with your own practice, a doctor, lawyer, a tuition teacher, etc., your income will be reported under this head.

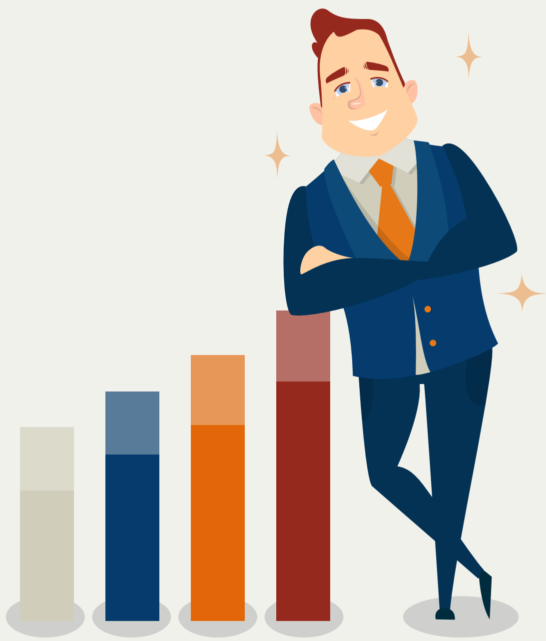
## 5. INCOME FROM OTHER SOURCES

Any other income you make in a financial year also needs to be reported. These may not fall under the heads mentioned above, but they also constitute income. Examples are interest on investments, interest earned on savings bank accounts, profit from gambling or a lottery, pension on death of a pensioner, etc.



## Tax Rates Applicable in India



Raushni earns Rs. 6 lakhs per annum while Rahul earns Rs. 20 lakhs per annum. Do you think it would be fair for both of them to pay the same percentage in taxes?

To make taxation fair in India, the government has formulated different tax slabs for individuals depending on their income levels. India has a progressive tax system, where individuals earning higher income must pay a higher amount of tax.

Until 2020, India had four different tax slabs for individual taxpayers. In April 2020, the government introduced a new tax system, with seven different income slabs with reduced tax rates. India allows you to choose whether you want to follow the old tax regime or the new tax regime.

**Here's a snapshot of the taxes under the two regimes for individuals up to 60 years of age:**

| Taxable Income (In Rupees) | Tax Rates | |
|---|---|---|
| | Old Regime | New Regime |
| Upto 2,50,000 | Exempt | Exempt |
| 2,50,001 – 5,00,000 | 5% | 5% |
| 5,00,001-7,50,000 | 20% | 10% |
| 7,50,001-10,00,000 | 20% | 15% |
| 10,00,001-12,50,000 | 30% | 20% |
| 12,50,001-15,00,000 | 30% | 25% |
| Over 15,00,000 | 30% | 30% |

Apart from the tax rates, there is another important difference between the new tax regime and the old tax regime.

The old tax regime has approximately 70 deductions and exemptions that you can use to reduce your tax liability. You can choose from a range of investment options and as well as choosing to make certain purchases such as buying medical insurance that can reduce your taxable income. As a salaried individual, you will be eligible for a standard deduction of Rs. 50,000. Under the new tax regime, most of these deductions have been done away with.

The tax slabs for women and men in India are the same at present. Until FY2012-13, there was a higher tax exemption limit for women. It has now been done away with.

## Key Differences Between the Old Tax Regime and the New Tax Regime

| Point of Difference | Old Tax Regime | New Tax Regime |
|---|---|---|
| Slabs | It has four income slabs on which individuals are taxed | It has seven income slabs for individuals |
| Standard Deduction | It allows standard deduction of up to Rs. 50,000. | There is no standard deduction that can be claimed. |
| Other Exemptions and Deductions | It has about 70 different exemptions and deductions that can be used to reduce income tax liability | Most exemptions and deductions are not allowed. Instead, there are lower income tax slabs that can be used. |

**However, some deductions are still permissible under the new tax regime. These include:**

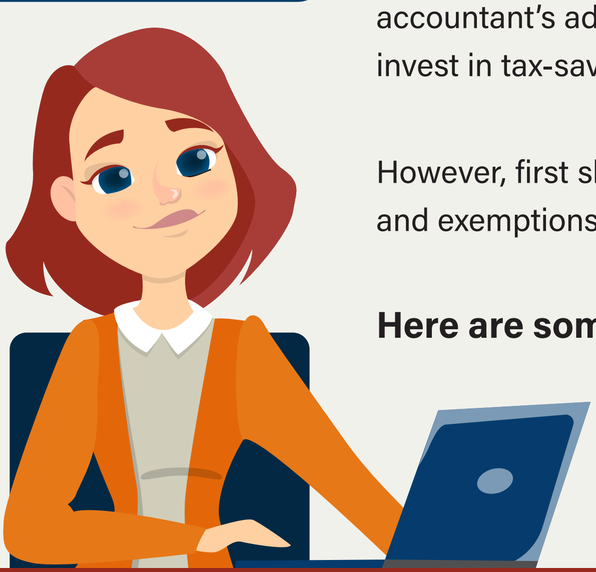
1. Post Office Savings Account interest of up to Rs. 3,500 for single accounts and up to Rs. 7,000 for joint accounts
2. Employer gratuity up to Rs. 20,00,000
3. Maturity amount and income from life insurance policies
4. Employer contribution to NPS and EPF
5. Any income from agricultural farming
6. Standard rent deduction
7. Retrenchment compensation
8. Retirement leave encashment
9. Proceeds from Voluntary Retirement Scheme of up to Rs. 5,00,000
10. Scholarship for education
11. Maturity and interest from PPF or Sukanya Smriddhi Yojna
12. Commutation of Pension

Choosing between the old tax regime and new tax regime is also an important decision to consider. If you choose the old tax regime, you need to do meticulous tax planning to ensure that you save money on taxation. This includes making decisions on various investments, deductions and other money-related things. If you tend to make investments and want to keep them locked up for the long term, you can choose the old tax regime.

However, if you are choosing the new tax regime, you can still benefit from tax planning by knowing exactly how much you will owe in taxes. It will help you make arrangements to make the payments.

While you can switch between the old tax regime and the new tax regime, the rules are a little stringent for business or professionally-employed individuals. Salaried individuals can choose which regime to opt for every year. Individuals with business incomecan switch from the new tax regime to the old tax regime only once in their lifetime. So, if you want to experiment with the two, you will need to do your research and then make the decision.

# Deductions Available



Raushni decides to put off her Paris trip for another year and instead, save on tax. With an annual income of Rs. 6 lakhs, she would fall under the tax bracket of 20% under the old scheme and 10% under the new scheme. However, upon her chartered accountant's advise, she decides to opt for the old scheme and invest in tax-saving instruments and claim deductions.

However, first she had to understand what are the best deductions and exemptions available to individuals under the Income Tax Act?

**Here are some of the most popular ones:**

1.

### EQUITY-LINKED SAVINGS SCHEMES (ELSS)

One of the best ways to save tax is to invest in ELSS. Investments up to Rs. 1,50,000 in ELSS are eligible for tax deduction under Section 80C of the ITA. They have the lowest lock-in period of 3 years.

2.

### PUBLIC PROVIDENT FUND (PPF)

Investments in PPF are also eligible for tax deductions up to Rs. 1,50,000 under Section 80C of the ITA. Moreover, it is one of the few investments that offer exempt-exempt-exempt benefit, meaning initial investments are eligible for tax deduction, interest earned is tax-free, and maturity amount is also tax-free. It has a lock-in period of 15 years.

3.

### SUKANYA SAMRIDDHI YOJANA (SSY)

If you invest for the future of your girl child under SSY, you are eligible to claim deductions up to Rs. 1,50,000 under Section 80C of the ITA. Once the girl child becomes 18 years old, the account ownership will be transferred to her.

4.

### NATIONAL PENSION SCHEME (NPS)

If you choose to invest in the government-sponsored voluntary retirement scheme, NPS, you can claim deductions of up to Rs. 1,50,000 under Section 80C of the ITA. Additionally, self-contribution of up to Rs. 50,000 is also eligible for tax deduction under Section 80CCD(1B).

5.

### MEDICAL INSURANCE PREMIUM

It's not just investments, but even expenses that can be used for tax benefits. Under Section 80D of the ITA, you can claim up to Rs. 75,000 as deduction from your taxable income if you buy health insurance for yourself, your spouse, your children or your dependent parents.

# Is It Too Late to Start Tax Planning in January?

Better late than never. Like Raushni, you can also plan your taxes now if you haven't done so yet. You still have two-three months left to optimize your taxes. However, ensure that you do not lose sight of your financial goals when planning your taxes.

For instance, while making 80C investments, ensure that you choose investments that meet your goals. If you do not want to lock up your funds for 15 years, you shouldn't invest in PPF. Similarly, if you are a risk-averse investor, then investing in ELSS doesn't make sense. However, you can opt to invest in ELSS via Systematic Investment Plan. This is a method of investing in mutual funds periodically in a systematic manner. The plan requires you to make regular, equal payments to a mutual fund scheme. By investing via SIPs, you avoid market timing. Instead, you invest throughout all market cycles. It is because SIP offers the advantage of rupee cost averaging wherein the fund manager buys more units when the scheme's Net Asset Value (NAV) is low and fewer units when it's high. In the long run, it allows you to average out your investment costs, manage market volatility, and reap the benefits of compounding. Don't make hasty decisions just to save taxes.

If you are investing in medical insurance, choose a policy that covers your needs. In short, invest according to your needs and goals.

# How to Plan Your Income Tax Smartly in the New Financial Year

When Raushni consulted her chartered accountant on tax saving, he advised her on how she could plan her taxes better for the next financial year.

1. Calculate all income sources and compute your tax slab correctly.

2. Depending on your tax slab, you can calculate what your tax outgo would be. Based on this, you can decide how to reduce your taxable income.

3. Choose different 80C instruments depending on your goals. Remember that you can save a maximum of Rs. 1,50,000 under 80C. Any investments beyond that won't qualify for tax deductions.

4. Consider other ways to reduce tax such as buying medical insurance, paying off a house loan, or an educational loan.

5. Spread out your tax investments through the year so that you don't feel the pinch.

By planning your taxes early, you can save more and reduce your stress associated with last-minute tax preparation. So, don't delay any further.

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|---|---|---|---|---|
| **Equity-Linked Savings Schemes (ELSS)** | **Public Provident Fund (PPF)** | **Sukanya Samriddhi Yojana (SSY)** | **National Pension Scheme (NPS)** | **Medical Insurance Premium** |

**With all these investment options at your disposal, start planning your taxes for the next financial year right away!**