Post TDS, there's more tax to pay

By Ameet Patel

A friend's father, recently came to me with some doubts about capital gains. Said he preferred investing in tax-free avenues like post office deposits, as opposed to bank deposits, which attract tax.

I was surprised!

Interest on post office deposits (like term deposits, monthly income schemes and national savings certificates) was, indeed, taxable. But no matter how much I explained, the gentleman was convinced that they were not.

I realised the cause of his confusion: in the case of bank deposits, the bank deducted tax before paying the interest. However, he received the full interest on post office deposits without any tax deduction. So, according to him post office deposits were tax-free.

This gentleman, like many others, could not tell the difference between tax payable and tax deducted at source (TDS).

TDS and 'tax-payable' demystified

Let's suppose you have rented out your house, for use as a guesthouse by some company, at a monthly rent of Rs 20,000. When the company pays you the rent, they will deduct tax (TDS) of 15% (Rs 3,000) and pay you the balance Rs 17,000. The company will then deposit Rs 3,000 to the government.

Here, ideally, it is your income and you are liable to pay tax on the income. But the government asked the payer of the rent to deduct the tax and pay it to the government on your behalf.

TDS is applicable for specific payments (specified by the government from time to time and currently include bank interest, rent, consultancy fees and some others) only and at specific rates (again as specified from time to time, rate for rent being 15% and bank deposits being 10%).

This is what TDS really means.

Myths about TDS

Myth 1: TDS is not the end of the road!

A common mistake made by people: they presume that TDS takes care of the entire tax liability on the relevant income.

Let's go back to the above case of rental income. The company has deducted tax only at 15%. Now suppose you also have a salaried income and you fall under the highest tax bracket of 30%.

Your actual tax liability will be 30% on your entire income in excess of Rs 250,000,

including rental income. That means you still have to pay a tax of 15% on your rental income.

As mentioned earlier, tax is deducted at specified rates only and not at the rate of tax applicable to the receiver of income. Therefore, in this case, you still need to pay a further tax of Rs 6,000 per month.

Myth 2: **Post TDS, You don't have to file your returns.**
Wrong! The income tax rules state that if your income is more than Rs 1.10 lakh (Rs 1.45 lakh for women and Rs 1.95 lakh for senior citizens), you must file your returns.

Suppose you don't have any salaried or other income, this means that your total income for the year is Rs 2,40,000 ie Rs 20,000 for 12 months (let's ignore the deductions that you get from rental income to make the example simple). And suppose you make investments of Rs 1 lakh, it will bring down your taxable income to Rs 1.4 lakh, ie.

You will fall under the lowest tax bracket of 10%. Now you owe tax only at the rate of 10%, but the company has deducted tax at 15%. Now just because you do not have to pay any more tax, it does not mean you do not have to file your tax returns. In this case you are eligible for a refund of 5% ie Rs 12,000 for the whole year. You will get the refund only if you file your tax returns.

Even if there is a scenario where you do not have to get any refund, you must still file your return. If the return is not filed, it is possible that the income tax officer may levy a penalty on you.

Myth 3: **TDS from your salary takes care of tax on other income, too.**

Many salaried professionals assume that since their employer has already deducted the tax payable on salary income, they do not have to pay any more tax. They forget that they have other income, too, in the form of bank interest and interest on bonds, etc, which is taxable. These sources of income also must be added to your salary, to arrive at your total income for the year minus TDS. Tax is payable on this amount for the year and not merely on one item of income such as salary.

An example: If you make Rs 5 lakh per annum, your employer will deduct a tax of Rs 99,000 on your salary income. However, he does not know that you have also invested in bank deposits, on which the interest is say, Rs 50,000 for that year. So, your TDS on salary does not take this source of income into account. It's up to you to pay tax on this income of Rs 50,000, when you file your returns.

Myth 4: **No TDS from a particular income? This means it is not taxable.**

Tax is required to be deducted from certain specified payments only. So, while bank deposits (where the interest exceeds Rs 10,000 pa) come under this list of specified payments, post office deposits like term deposits, monthly income schemes and national savings certificates do not. They are exempt from TDS. That means that the post office will not deduct tax from interest on these incomes before paying you.

This does not mean that the interest is tax-free. It would be taxable in your hands and, in fact, because no tax is deducted at source, you would need to pay the same

either by way of advance tax during the year or by way of self-assessment tax, when filing your returns.

Myth 5: **Employers deducts TDS from salary. My tax woes are now over!**

No doubt that if you are a salaried employee, your employer is responsible for deducting tax and paying it on your behalf. However, if your employer makes a mistake in calculations and deducts lower tax than required, it is for you to pay up the remaining tax while filing returns.

TDS is only a mechanism for collecting your tax. If that mechanism fails or is faulty, you still have to pay tax. While the government can penalise the employer for making a mistake, you have to pay the shortfall in TDS.