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SUBJECT : TDS ON SALARIES PAYMENT

DATE : July 07, 2006

We hereby summaries provisions relating to deduction of TDS from salaries payment.

TDS ON SALARIES PAYMENT

The IT Act lays down elaborate steps to be followed by an employer while deducting the tax (popularly known as TDS) from the salaries. There are various constraints on the employer.

To start with, there are deadlines for TDS payment to the government; for issuing the TDS certificates (Form 16) to the employees; for filing quarterly e-TDS returns, and many more of such legalities. Plus, there are various penalties and interests that an employer has to pay if there is a default. These detailed procedures might in part explain why most employers are paranoid when it comes to TDS.

The Process

To calculate the TDS for each employee, an employer typically follows these steps:

- Estimating the gross salary for the entire year;
- Estimating the exemptions from the salary income;
- Adding any other income, declared by the employee;
- Calculating the amounts of deductions from the salary income based on the declaration given by the employee;
- Calculating the tax on the net income of the employee;
- Deducting the tax equally over 12 months of the year;
- Paying TDS to the government every month by the 7th of next month, filing e-TDS return every quarter;
- Issue Form 16 (TDS certificate) to each employee.

Computing salary income: To compute total income under the head of 'income from salaries', there are various items of income that form part of salary. Salary includes the basic salary, advance salary, the wages, pension, fees, commissions, bonus, taxable gratuity, leave salary, leave encashment salary (not otherwise exempt), profits in lieu of salary, taxable house rent allowance and other taxable allowances.

Not all allowances and perquisites received by an employee are liable to income tax. Some of the allowances and perquisites are totally exempt from income tax, some are partially exempt, while others are fully taxable. There are separate limits and conditions for exemptions for various allowances.

For example, house rent allowance (HRA), leave travel allowance (LTA), medical reimbursements, conveyance allowance each have a different limit and a different set of rules. An employer has to apply each set of rules and limits before deciding what is exempt and what is not.

Tax to be evenly deducted: What is important for an employee to understand is that the employer is supposed to deduct tax equally over the entire 12 months. Thus, if the total tax to be deducted from the salary for the year is Rs 12,000, then the employer is supposed to deduct Rs 1,000 every month and pay that to the government. If he fails in this, he is penalised.

TDS on other income: A salaried person is also liable to pay income tax on income from other sources like interest, capital gains and rental income. These are computed under different sections of the Income Tax Act. An employee has the option of declaring his other income to the employer, so that the tax on that income can also get deducted from the salary income. By doing so, the employee can avoid the formalities of paying advance tax (which would have to be paid if the tax is not deducted at source).

Deductions allowed: After the gross salary is calculated and the exemptions given, the deductions under Section 16 of the IT Act have to be made. Earlier, employees were entitled to standard deduction. Now, that is no longer available. The only deduction remaining is dues paid as professional tax. The balance figure is the amount of taxable salary.

From the taxable salary, the employer can then reduce the deductions permissible under Chapter VI-A of the Income Tax Act. Simply put, he will allow the following deductions:

- Under Section 80C: for the various tax saving investments like PPF, life insurance premium, among others.
- Under Section 80CCC: for investments in pension schemes by life insurers.
- Under Section 80D: for mediclaim premium.
- Under Section 80DD: expenses incurred for medical treatment or amount deposited under any scheme framed by the LIC/UTI approved insurer/administrator, for a dependant with ordinary disability or severe disability.
- Under Section 80E: interest on loans for education.
- Under Section 80GG: for house rent paid.
- Under Section 80U: a deduction of Rs 50,000 in respect of a person who at any time during the previous year is certified by a medical authority to be a person with a disability.

Another important deduction that an employer is allowed to make from the income pertains to the interest on housing loans up to a maximum of Rs 1.5 lakh per year. Of course, for this, just as for other deductions, the employee would have to furnish proof to the employer. It may be noted that there are limits laid down in the Income Tax Act for each of these sections.

Deductions not allowed: One important point to be noted here is that although a taxpayer may be entitled to several deductions from his income for the purpose of TDS from salary, the employer cannot reduce all the deductions.

He can give credit only for those deductions that are mentioned in the annual circular issued by the government. Thus, a taxpayer may have given a donation to say, CRY and for this, he would be entitled to deduction under Section 80G. However, while calculating TDS from salary, the employer is not allowed to take this into consideration. As far as donations are concerned, an employer is allowed to take into consideration only donations given to the Prime Minister's Relief Fund and a few other similar donations.

The employer has to then calculate the tax payable on this income and deduct this tax in equal monthly installments. Tax is to be deducted by the employer at the time of payment of salary or at the time of credit of the salary whichever is earlier. Tax will be deducted only if the total income of the employee exceeds the threshold limit of Rs 1 lakh in case of male employees, Rs 1.35 lakh in case of female employees and Rs 1.85 lakh in the case of senior citizens.

One-time payments: In some situations, one-time payments are made during the year -- for example, bonus, incentives, joining bonus, and the like. The tax payable on such an amount would be deducted immediately. For example, if an employee is in the top tax bracket (that is 30 per cent) and his income is more than Rs 10 lakh, and gets a Diwali bonus of Rs 1 lakh, then the employer would deduct Rs 33,660 (Rs 30,000 as tax and Rs 3,000 as surcharge at 10 per cent on the tax and Rs 660 as education cess at 2 per cent on the tax plus surcharge) from the bonus/increment and pay the net amount to him.

If the employer fails to deduct the whole or any part of the TDS, then he shall be liable to pay simple interest at 12 per cent on the amount not deducted or short deducted.

The Timing

After the tax is deducted, the employer has to pay it to the government within 7 days from the end of the month. At the end of the year, the employer has to issue the salary certificate to the employee. While doing this, the employer has to quote the correct permanent account number (PAN) of the employee in the certificate. If the correct PAN is not quoted or if the same is not quoted at all then the employer is penalised.

So if you were thinking that the nosy accountants in your office were too eager to hack your salary to pay to the government, you have to give them the benefit of doubt. Deducting tax from salary is as painful, if not more, for the employer as it is to the employee.